FX Daily: Position-squaring keeps hitting the dollar

The outperformance of the oversold antipodeans (AUD and NZD) at the start of the week seems to suggest that position-squaring is the main cause behind USD's current soft momentum. We think that a more balanced positioning can now help the dollar stabilise. It should be a relatively quiet day ahead of tomorrow's ECB and BoE meetings

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USD: How long can the long-squeeze last?

Another good day for global equities left the dollar quite vulnerable, particularly against the pro-cyclical currencies. Here, the antipodeans AUD and NZD are continuing to show the biggest reactiveness to equity dynamics and are rebounding strongly after a grim second half of January, also thanks to their quite stretched net-short positioning.

The antipodeans' strength seems to suggest that position-squaring is indeed behind this week's dollar weakness, and we expect the dollar's positioning now to have reached a somewhat more balanced level which can allow for some stabilisation. After all, a market that is quite freely speculating on the pace and size of Fed tightening is unlikely to turn much less bullish on the dollar anytime soon.

Today, markets will focus on US ADP employment figures, with consensus estimating a material deceleration (from 800k to 180k) in January. The ability of ADP numbers to predict the actual payroll figures is not very high, and given that markets are already expecting some pretty unexciting NFP jobs data on Friday, we think the impact on the dollar of today's release should be quite contained. We still think DXY can hold above 96.00 this week.

EUR: 1.1300 should be a tough resistance

With latest CPI numbers having offered a rare idiosyncratic push to the EUR and markets taking profit on bullish USD positions, EUR/USD has remained quite bid, now eyeing the 1.1300 level. This is a level that could indeed see some resistance and attract many sellers, so we are inclined to think EUR/USD will remain in the 1.1250/1.1300 area into tomorrow's ECB meeting.

As discussed in our EUR and ECB Crib Sheet, we see mostly downside risks for the pair as the hawkish bar has been set higher after the strong German CPI numbers on Monday and we expect President Lagarde to keep showing patience on inflation and tightening.

GBP: Flattening up ahead of BoE announcement

EUR/GBP pared Monday's gains yesterday, getting back on track to test the 0.8300 support tomorrow when we expect a combination of a BoE hike and a patient ECB to generate more pressure on the pair.

Today, the calendar is very light in the UK, and a wait-and-see approach ahead of a 'super-Thursday' for the two major European central banks could keep GBP mostly range-bound against the USD and the EUR.

CAD: Keep an eye on Macklem's comments

The loonie's slightly overbought condition (according to CFTC data as of 25 January) is likely behind the quite contained recovery in the currency compared to other oversold pro-cyclicals like AUD and NZD. Incidentally, oil prices have proven resilient, but CAD cannot currently count on a strong rally in crude as it did earlier in January.

That said, rate differentials continue to offer a bullish argument for the loonie, and markets are currently pricing in six BoC rate hikes in 2022, even though the Bank refrained from hiking in January. This may be a key topic in today's Senate testimony by the Bank of Canada Governor Tiff Macklem, as policymakers may question whether the Bank is doing enough to fight inflation. Hawkish comments by Macklem may both consolidate markets' view around six hikes in 2022 and fuel speculation about a 50bp move in March.

We could see CAD edge back to 1.2600 thanks to the supported environment for pro-cyclical currencies this week. We think that the aggressive BoC tightening cycle will provide some substantial support to the loonie this year, and we expect a move below 1.25 by the summer.

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