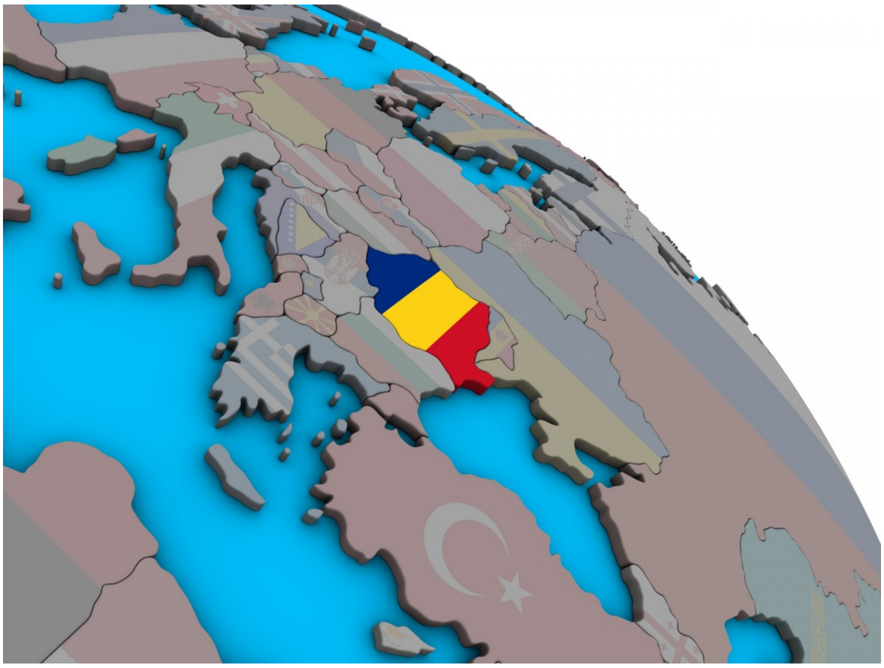
FX Daily: Romania's turn for the big hike

FX markets look as though they have entered a more consolidative, risk-positive environment helped by comments from the Fed's Clarida that a possible first tightening may not come before end 2022. That view could be challenged tomorrow with a strong October CPI release, but until then narrow ranges look likely. Look out for a rate meeting in Romania today



USD: 3.8% is the magic number

The dollar is gently softer against most currencies and helping this we think were comments from the Federal Reserve's Richard Clarida. His remarks on monetary policy yesterday suggested that the Fed was in no hurry to shift from tapering to tightening, giving an end 2022 indication for a Fed rate lift-off. What we found interesting was his comment that a 3.8% unemployment rate would be consistent with the US economy having reached 'maximum employment' - meeting one of the two criteria for the Fed to tighten. Expect to hear more about this 3.8% number and were the unemployment rate (last 4.6%) to make faster gains towards it, the pricing of the Fed tightening cycle could be brought forward too.

Ahead of tomorrow's October US CPI data, today we will see NFIB small business optimism data.

Let's see how this has held up in the face of higher energy prices, though the core story should remain the supply-demand imbalance in the labour market and the high intention to pass on price increases.

DXY feels like it could drift back to the 93.70 area as we wait for tomorrow's CPI data.

Elsewhere, the FT reports that $120bn of foreign portfolio capital has entered Chinese local currency debt and equity markets over the last year. That may be more bond-related given China's inclusion in the FTSE Russell WGBI bond index. The inclusion started last month and the phase-in will take three years. FTSE Russell estimates that foreign inflows based on this inclusion could be worth $130-160bn. Renmimbi demand from the investment community, plus China running record trade surpluses on weak imports look to be two good reasons why the trade-weighted renminbi remains at its highs for the year.

EUR: $1.1500 looking solid

Some gentle dollar weakness amidst continued gains in global equities has dragged EUR/USD back above 1.1600. That suggests that even if we do get a high US CPI number tomorrow, breaking below 1.1500 looks quite a stretch - and may have to be a story for 1Q22. For today, the eurozone calendar is relatively quiet, with focus on the German ZEW investor survey and a few ECB speakers. On that subject, arch-dove Philip Lane certainly stuck to the script yesterday. We hear from a hawk today, Klaas Knot, at 15CET.

Elsewhere, tension between the EU and Poland remains after the European Court of Justice ruled yesterday that Poland had politically interfered in its local judiciary. Poland is now threatening to withhold its EU membership fee. So far, this dispute does not seem to be weighing on the zloty, where the focus instead remains on whether the National bank of Poland will hike rates again on 8 December. Our team feel that is likely.

GBP: Finding some support

Having suffered a torrid couple of sessions, GBP has started to find a little support. It is hard to ascribe that to Bank of England tightening expectations being re-built. After all the December 2022 Short Sterling contract is still 25 ticks above where it was on the eve of Thursday's BoE meeting.

Instead, one suspects that cable is tracing out a broad 1.34-1.38 range that will last into year-end and that the speculative community did not have enough conviction to drive it below the September support levels. Expect more subdued trading from GBP into Thursday's release of UK 3Q GDP data.

RON: National Bank of Romania set for 50bp hike

As Valentin Tataru outlined in his preview, today we expect the National Bank of Romania (NBR) to follow up some other large hikes in the region with their own 50bp rate hike. That would take the policy rate to 2.00%. The rationale for the move would largely be one of trying to keep inflation in check - CPI could hit 8% YoY later this year. But the NBR is also reluctant to let the policy rate cushion over its CEE peers, Poland and Hungary, compress too much in case 'fluid' capital starts to leave the leu.

Valentin makes the intriguing point that the hike could be more sizable if the NBR disproprtionately adjusts the policy corridor, where the deposit and lending facilities currently sit -/+ 50bp around the 1.50% policy rate. He suggests we should keep a close watch on the lending facility rate. A 100bp increase in the lending facility to 3.00%, and the NBR's customary use of liquidity management techniques, could see money market rates rise towards that 3.00% area and the NBR effectively having delivered a 100bp rate hike.

We think the NBR's move should be enough to keep EUR/RON trading under 4.9500, helped by attractive implied yields. 3m RON implied yields derived through the EUR FX forwards are now 3.60% per annum.

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