

FX Daily: The 6% scare

US headline inflation looks set to get close to the 6% level at today's read, and we think the dollar may benefit from some hawkish re-pricing of Fed rate expectations. Meanwhile, we'll keep an eye on the Powell-Brainard race for the Fed leadership, with Biden set to announce the nomination soon. Elsewhere, Australia's jobs data may help AUD recover.



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USD: CPI and Fed leadership race in focus

The dollar has enjoyed some stabilisation after having modestly weakened across the board at the start of this week. Still, G10 FX volatility has remained subdued after last week's central bank meetings and amid a lack of clear data catalysts.

This may change today as markets will have to weigh a US inflation report that looks set to show yet another acceleration in price growth. Consensus is looking at a jump from 5.4% to 5.9% in the headline rate, with core expected to advance from 4.0% to 4.3%. Our economics team sees surging housing, labour and energy costs all contributing to the further rise in prices and expects a break above 6% in headline inflation by the end of the year.

Inflation at 6% is set to offer more ground to the Fed's hawkish members to keep raising concerns

about the risks of acting too late or doing too little on monetary tightening. Today, we think the risks are skewed towards a positive reaction by the dollar, as slightly below-consensus numbers (but still higher than last month) should not be enough to cause any dovish re-pricing in rate expectations – which are already less hawkish than the Fed’s median Dot Plot – while a close-to or above 6% read could prompt markets to bring forward the pricing for the start of the Fed’s tightening cycle. We think DXY may rise back towards Friday’s 94.600 high by the end of this week.

The US economy is surely heating up, but so is the race for the next Fed chair, with a decision set to be announced by President Biden in the coming days. Consensus is still on Jay Powell being confirmed for another mandate, but the news that Lael Brainard (as of now, Powell’s only contender) has been interviewed by Biden seemed to have revamped the chances of a change of leadership at the Fed. Brainard has been amongst the FOMC’s most dovish voices in recent times, and there may be some downside risks to the dollar if she is nominated as markets may expect a more cautious approach to monetary tightening. A confirmation of Powell in his role still looks like the most likely option, and should have either a neutral or slightly positive impact on the dollar.

⬇️ EUR: Re-testing 1.1500 soon?

EUR/USD had held up around 1.1600 before falling this morning, after yesterday’s ZEW survey results out of Germany came in quite mixed, as more upbeat expectations offset a quite grim assessment of current conditions. We think we could see some extra EUR/USD weakness today as US CPI numbers are released and the eurozone data calendar does not include any market-moving releases. 1.1500 remains the key level to watch, and a support that may be increasingly pressured in the near term.

Elsewhere in Europe, Norway’s October CPI data showed a larger-than-expected slowdown in inflation (from 4.1% to 3.5%). With inflation still likely to press higher again in November and December, it appears unlikely one below-consensus read will dent the Norges Bank hiking plans for December and for 2022. The lack of any negative impact on NOK from this morning’s release indicates how there is a high level of conviction the NB will stick to its projected rate path.

⬇️ GBP: Brexit risk not evident on the pound

EUR/GBP has flattened around the 0.8550 level after having nearly touched 0.8600 earlier this week. There aren’t many catalysts driving the pound at the moment, as markets await new data to weigh the timing of the first BoE hike after last week’s surprise hold.

Some downside risk may emerge for the pound in the coming days as it looks increasingly likely that the UK will unilaterally suspend parts of the Northern Ireland Protocol. Yesterday, Ireland’s deputy prime minister said that the EU will have “no option” but to retaliate should this happen. For now, EUR/GBP is not showing clear signs of any political risk premium being built up.

⬆️ AUD: Finally signs of rebound in the jobs market?

AUD has been the worst-performing G10 currency this week, and has lost around 2% against the dollar since the RBA abandoned its yield-curve-control policy on 2 November. AUD/USD remains in undervalued territory (-1.5%, according to our short-term fair value model) and still has significant room to catch up with the previous jump in short-term AUD yields on the back of speculation the April-2024 yield target would be dropped. Incidentally, AUD had remained [the most oversold currency in G10](#) into the November RBA meeting, according to latest CFTC data.

Jobs data tomorrow at 00:30 GMT could be the catalyst for a correction higher in AUD, as after a number of grim jobs report due to the impact of Covid-19 lockdown, looser containment measures in October should have fuelled a net increase in employment. The unemployment rate may still inch higher as the participation rate is also set to rise, but we think markets will mostly look at the headline employment figure as a potential sign that the worst of the pandemic hit in Australia is past us. This should cement bets that the RBA will not be able to stick to its plans to keep rates on hold until 2024, and we think could trigger some short-squeezing in the heavily oversold AUD/USD. We expect a move back above 0.7400 this week.

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