FX Daily: The dollar is not the only game in town

There is a myriad of inputs driving exchange rates currently. Some central banks are pushing ahead with tightening cycles, while others are becoming more cautious. And the commodity boom is still driving real gains for some too. Upbeat NFP jobs figure today should help the dollar against the low yielders. But the dollar isn't the only game in town

Content
- USD: Upbeat NFP can provide a small lift
- EUR: Looking vulnerable in a world of tighter policy
- GBP: BoE edges towards the tightening camp
- ILS: The BoI backs away

USD: Upbeat NFP can provide a small lift
Casting around the globe, we see myriad factors driving exchange rates currently, such that FX markets are not simply dominated by the dollar story.
Several central banks in the emerging market have embarked on aggressive tightening cycles to ride out the summer spike in inflation and keep 2022 inflation expectations under control. Brazil and Russia stand out here, but we have also seen tightening cycles launched in Mexico and Chile. In Europe, the Czech central bank hiked again yesterday and forecasts that short term money market rates could be close to 2% in 2022 - that is not bad for low-yielding Europe. The slower vaccination pace leaves Asia generally on a different cycle. China recently cutting the rate on its reserve requirement ratio, and southern Asia struggling with new case numbers.
Yet Korea may be considering launching a tightening cycle over the coming months. And most recently, the BoE is edging towards the Fed, Canada and Norway in openly discussing the need for tighter policy over its forecast horizon. Monetary cycles also have to be overlaid with impressive Terms of Trade gains delivering huge trade surpluses for some commodity exporters. Plus, political cycles will be making a comeback too.

In this context, it is too simple to hang FX markets merely off a dollar view. What we would say, though, is that today our team are forecasting a healthy +900k increase in the July NFP report. Driving that should be the end of extra unemployment insurance benefits in 25 US states, which should increase the supply of labour. This trend should only increase as the year progresses - especially when children return to school in September.

Following a reasonably explicit call from Fed’s Clarida on Wednesday that the US economy would likely meet conditions to justify interest rate tightening by the end of 2022, a strong US jobs number today should see the US money market rates continue to work their way back to the highs seen in early July. This should support the dollar against the low-yielders of JPY and EUR, where the ECB and the BoJ are positioning themselves as the last in the queue to tighten. DXY could push back to the 92.65 or even 92.85 area today, while USD/JPY could head to 110.60.

EUR: Looking vulnerable in a world of tighter policy

As above, many central banks are edging towards or have sprinted through the exit door of ultra-loose policy. The ECB is not one of them and, like the Fed did last September, have created a framework where better activity data (but rates on the floor) can keep real interest rates deeply negative. We’re seeing that most keenly expressed in EUR/CHF, but also in EUR/GBP and now also in the likes of EUR/CZK and EUR/HUF where tightening cycles are underway. Until the ECB starts to express comfort with the inflation trajectory, expect the EUR to remain a laggard. EUR/USD could trade back to the 1.1750 area today should NFP come in near our forecasts.

GBP: BoE edges towards the tightening camp

The BoE delivered a slightly hawkish message yesterday, including a conclusion that some modest tightening may be necessary should things go to plan. That may be a small step for the BoE, but it is a giant leap compared to ECB communication. That’s why, after trying to work out what Quantitative Tightening might actually look like, the market too EUR/GBP down to the lows of 0.8490. With the BoE’s finger now on the trigger - any better UK data could start to see some out-size reaction in GBP as BoE tightening expectations are brought forward from November 22 - when the first full 25bp is priced. We favour EUR/GBP remaining heavy and could press the 0.8470 March low today, should a strong NFP drive EUR/USD lower.

ILS: The BoI backs away

Another of the surprising FX moves this month has been the Bank of Israel (BoI) scaling down its intervention and allowing $/ILS to trade below 3.24. Remember, the BoI drove $/ILS to 3.35 earlier this year by announcing a $30bn FX intervention to fight ILS strength. In July, the BoI only intervened to the tune of $500mn versus $3.6bn in
June.
What's changed? Perhaps the Bol is welcoming the first government-approved budget in three years. We note that the budget contains some measures to make imports easier as the government seeks to reduce Israel's relatively high cost of living. Could a stronger ILS help here too? Or perhaps it is a more conventional monetary approach taking place, where instead of deflation, Israel CPI is now 1.7% YoY - the highest since 2014 - and the Bol may be less averse to a stronger ILS.
We think $/ILS can drop down to the 3.20 area, and the surprise package would be a drop back to the lows of 3.11 - levels that prompted such a big response from the Bol back in January.