

## FX Daily: Stronger dollar comes in handy

Trade-weighted measures of the dollar have pushed up to the highest levels of the year as surging US inflation makes the case for tighter monetary policy. High inflation is now a hot political topic in Washington and presumably both the Fed and the White House would not mind a stronger dollar right now.



Source: Shutterstock

### **USD: Inflation becomes political, stronger dollar helps fight it**

October's [surge in US inflation](#) is now a hot political topic in Washington. The Democrat administration is trying to get its Build Back Better \$1.7trn stimulus package through Congress, yet a key swing voter in the Senate, Democrat Joe Manchin, is concerned about inflation and may well delay his support for the package into next year. His concerns stem from the inflationary impact of prior stimulus packages. Clearly higher inflation is becoming problematical for both the Administration and the Fed. In this light, we suspect Washington will not mind the dollar breaking to the highs of the year as the currency can do some of the tightening of monetary conditions. The dollar move, at the margin, can also fight against high commodity prices at a time when President Biden is being pressured to release strategic oil reserves.

Veterans Day holiday suggests a quiet day of FX trading ahead, but a narrative of inflation staying high/heading higher, further employment gains, and a Fed needing to exit loose policy more

quickly should keep the dollar bid on dips.

DXY (currently 94.87) looks like it is heading to the 96.00/96.10 area multi-day.

## ⬇️ EUR: \$1.13 looks the bias this month

1.1500 support has given way in EUR/USD without much fanfare, yet the FX options market is starting to show some backing to the move. Here there seems to have been buying interest in the one year and two year part of the volatility curve. Technically, the spot move looks as though it can extend to the 1.1300/1330 area this month. Our FX options team also suggests the market has been preparing for this EUR/USD downmove by buying EUR/USD put spreads - effectively expecting a slow grind lower rather than any fireworks.

For today, look out for Autumn European Commission forecasts today. In the summer the EC had forecast Euro area growth at 4.8% and 4.5% (21/22) and inflation at 1.9% and 1.4% (21/22). Presumably, the focus will be on how much the 22 inflation is revised higher.

A US holiday should mean quiet trading, yet we do we favour some downside follow-through after yesterday's break of 1.1500 support.

## ➡️ GBP: GDP not quite as strong as 0.6% MoM suggests

EUR/GBP has edged up on what seems to be a softer 3Q GDP print (1.3% vs 1.5% consensus) than expected, even though the September MoM figure was a little better than expected. Please look out for a write-up on this from James Smith shortly.

We are not as bearish as some on GBP and believe that the BoE tightening story will resume over coming weeks as we build towards the December 16th rate meeting. Our short term Financial Fair Value (FFV) model suggests GBP is perhaps trading with a 1% risk premium in it already, but we doubt that EUR/GBP needs to trade over 0.8600.

## ⬆️ MXN: 25 or 50bp from Banxico today?

Banxico meets today to set interest rates. Most economists favour a 25bp hike in the policy rate to 5.00%, although a few are looking for a 50bp hike. Banxico has been one of the more gradualist central banks in the EM space and with the Peso performing quite well and inflation (6.2% YoY) not quite as bad as some of its neighbours - e.g. Brazil at 10.7% YoY - a 25bp hike may be enough for the time being.

A core theme this year has been Mexico benefiting from strong US final demand - a theme that should extend well into 2022. And even though MXN is a high beta currency, we think Mexico's stronger sovereign balance sheet relative to EM peers (e.g. investment grade and a 5-year USD CDS at 100bp) stands it in better stead than many in response to a more difficult external environment.

A 25bp hike today may disappoint a money market priced for a more aggressive tightening cycle (100bp+ of tightening priced over the next three months), but we suspect USD/MXN continues to find selling interest on rallies to the 20.75/21.00 area.

## Authors

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

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