50bp increments doesn't necessarily mean FX strength

13th April 2022

GBP

The pound started this morning on a firmer footing, especially after this morning's March CPI data saw inflation in the UK rise to 7% and outstrip expectations. However, since the release, a broad bid in the dollar from rising Treasury yields and a lower open in European equity markets has resulted in GBPUSD falling over 0.2% on the day. While the increase in March's CPI confirms to us that the Bank of England will continue to hike rates to 1% in May, this hasn't provided the pound with much shelter from the broad dollar bid despite two-year Gilt yields rising 6.5bp after trading began.

EUR

EURUSD moved to fresh one-month lows this morning and is heading towards March's key support level seen on the day Western countries imposed sanctions on Russia following the invasion of Ukraine. The war is the main driver fuelling EUR weakness at the moment, with President Joe Biden for the first time referring to Russia's violence as genocide, significantly escalating his condemnation of Putin's invasion. If it wasn't for US inflation, EURUSD would have likely traded even closer to March's support level this morning, however the MoM decrease in US core inflation pushed US 2Y and 10Y yields lower, which suggests US rates markets for once are not behind the EURUSD moves. Instead, the focus on geopolitics remains strong. The New York Times wrote the risk of Vladimir Putin using chemical weapons in Ukraine looms large, while other newswires have been discussing whether chemical weapons have been used in Mariupol already. In such a scenario, further measures are likely to be taken against Russia and the case for the eurozone not sanctioning Russia's energy exports may become too politically damming.

USD

Yesterday, the broad US dollar index sold off sharply after March's inflation data showed core CPI unexpectedly moderate to a monthly gain of 0.3%, down from 0.5% in February. That overshadowed headline inflation beating expectations, as the gain in headline inflation was mostly due to a massive increase in energy prices throughout March which was bound to arise given the war in Ukraine and supply chain disruptions from China. The dollar recovered throughout the remainder of yesterday's trading session without a major catalyst, as neither the 2Y nor the 10Y yield managed to recover. Still, the greenback closed higher than it started the day, while the S&P 500 index also changed course to limit losses on the day. This coincided with President Joe Biden accusing Russia of genocide in Ukraine, which possibly weighed on risk sentiment. Overnight, the move in US Treasuries reversed again when Federal Reserve Governor Lael Brainard stated the Fed will move expeditiously to raise rates and return the soaring inflation to its 2% target and Fed hawk James Bullard said it is "fantasy" to think modest rate rises will tame inflation.

CAD

The Canadian dollar was left virtually unchanged upon Tuesday's close despite making sharp moves during the day. Like Monday, the loonie's price action was largely the result of US developments rather than anything on the Canadian front. However, it wasn't just a moderation in US yields that boosted the loonie. Oil played a supportive role too with WTI crude up almost 7% on the day to trade back above $100 per barrel. The move in the North American oil benchmark came after Vladimir Putin vowed to continue the invasion of Ukraine, which could possibly lead to a further withdrawal of Russian oil supply from the global market, while signs of gradual easing in China's lockdowns helped boost crude's demand outlook. Today's big event is the Bank of Canada policy decision. Interest rate expectations have risen since the last meeting, and now markets and analysts are in agreement that the Bank of Canada will likely hike by a larger-than-normal 50bps to 1%. If the BoC follows through, that will be the first 50bp rate hike in 22 years. However, a 50bp doesn't necessarily lead to a rally in CAD, as evidenced by this morning's RBNZ meeting.

FX Elsewhere

Overnight, the Reserve Bank of New Zealand hikes the overnight cash rate (OCR) by 50bp to 1.5%. This was a larger increase than consensus, which has 15 of the 20 economists surveyed by Bloomberg forecasting a 25bp move, but was closer to money market pricing of a 75% probability of a 50bp move. The RBNZ framed the decision around the need to keep inflation expectations anchored by pulling forward the pace of tightening such that the medium-term rates outlook doesn't need to be reassessed. After initially rallying, the Kiwi dollar began to sell off as local rates traders priced in a lower end-point for the OCR over the projected hiking cycle and sell-side analysts began to issue notes labelling the decision a dovish 50bp hike. With markets expecting the likes of the BoC and the Fed to also take out an insurance policy of a 50bp hike, G10 FX traders can take some lessons from how today's RBNZ meeting played out.

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