Bond markets continue to call the tune for FX markets with key rate decisions due

2nd November 2021

GBP

Price action in the pound was largely uneventful yesterday despite 2-year Gilt yields rising to their highest point since May 2019. The pound took on water against both euro and dollar in what was a mixed G10 session yesterday, but despite a more robust showing from the US dollar today across the G10, sterling remains somewhat stable as European markets enter. With the data calendar sparse, positioning ahead of Thursday's pivotal Bank of England meeting will largely determine GBP price action, along with bond market pricing.

EUR

European stocks rose to a record high on Monday as expectations of policy tightening continue to support equity markets while corporate earnings also continued to support risk appetite. The highs were hit despite the backdrop of supply bottlenecks, more persistent inflation and slower growth, but came as investors await the latest responses by central banks to above-target inflation. While inflation by itself may not be a good sign for earnings as companies may fail to keep pace with rising costs, inflation expectations have filtered through to policy expectations - even for the European Central Bank - which in turn helps earnings. Last week's ECB meeting saw the euro strengthen as markets were not convinced of President Lagarde's pushback on rate expectations, and going forward the battle between markets and the ECB is likely to become more pronounced especially as the Pandemic Emergency Purchase Programme comes to an end and is potentially bridged by higher bond-buying through the Asset Purchase Programme or the creation of a new programme. For today, focus will be on manufacturing Purchasing Managers' Index figures throughout the morning and the ECB's Elderson and de Cos at 11:20 and 11:55 GMT respectively.

USD

It has all been about bond yields again in FX markets, with the dollar initially trading on the front foot in yesterday's trading session before retracing early gains as Treasury yields moderated across the entirety of the curve. The greenback's losses were largest against risk currencies within the G10 space, while ground was still claimed against GBP and JPY. Today, the dollar looks to have bounced, although the DXY index still trades in the red as lower Treasury yields support a slight rally in JPY. Against the rest of the G10, however, the dollar is on the offensive, with losses largest in the antipodean currencies after the RBA pushed back on expectations of normalisation. On the data front, yesterday saw the release of October's ISM readings. The data showed new orders continued to moderate while price pressures grind even higher for manufacturers. The data only adds to the inflationary backdrop that is seen across the globe and reiterates the predicament that faces the Federal Reserve ahead of tomorrow's policy announcement.

CAD

The loonie closed higher on the day against the US dollar yesterday as gas and oil prices advanced given the risk-on market mood, while stocks rose and US Treasury yields slipped. USDCAD is coming off of a big week after the Bank of Canada policy decision last week and ahead of tomorrow's Federal Reserve meeting, with both central banks moving away from loose policies implemented over the pandemic. This morning, the Canadian dollar is seeing more notable losses against the US dollar compared to other G10 currencies, but this is likely a retracement from yesterday's moves. Today's calendar is sparse for Canada, with building permits being the only data release of note at 12:30 GMT ahead of the crucial FOMC meeting on Wednesday and Canada labour market data on Friday.

FX Elsewhere

The Australian dollar leads losses in the G10 space this morning after the Reserve Bank of Australia failed to live up to the markets' hawkish expectations. While the central bank abandoned its yield curve target of 0.1% up until its April 2024 bond, which was smashed by markets as of Friday last week, Governor Lowe said that this doesn't necessarily mean that interest rate rises are likely. Lowe stated that it was still "likely to take some time" for inflation to sustainably return to target and for wage growth to hit the 3-4% level required for higher interest rates. While the Governor tipped his hat to the prospect of rates rising in 2023 as opposed to 2024 that was previously signalled, the overall read of the RBA was much more dovish than markets had been pricing. This led to an unwind in AUD long positions and a decline in front-end Australian bond yields, with the Aussie dollar currently trading 0.73% lower against the US dollar.