

# Friday's robust reversal puts markets on edge ahead of central bank meetings

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## GBP

All eyes within the FX space sit on sterling this week as a pivotal Bank of England meeting is scheduled for Thursday. Following hawkish commentary from Governor Bailey over the past month or so, money markets have upped the ante on the likelihood of the Bank raising rates this month and again in December's meeting such that the Bank Rate closes the year out at 0.5%. While we don't believe the Bank will raise rates this week, it is a call that is very much against consensus, but we also argue that the decision to hike or not in isolation will mean very little for spot markets. The delivery of the interest rate decision will be the key aspect and whether the Bank's forecasts, which are based on a very hawkish interest rate path, confirm that the market has indeed got it right. Ahead of the decision, we have the final reading of October's PMIs both today for the manufacturing index and Wednesday for the services and composite readings, while Brexit headlines still roll-out in the background.

## EUR

While all currencies were hit by a stronger dollar on Friday, additional euro weakness on the day prompted declines of over half a percentage point in EURJPY, EURAUD, EURCAD and EURNZD, reversing gains seen after Wednesday's European Central Bank meeting. The move came after European yields rose substantially, with the Greek 10Y rising 23bp while the Italian counterpart rose 11bp. Rising yields in Europe are no complete surprise given the prospect of less pandemic asset purchases by the ECB over the next months, but the widening of spreads in the eurozone may be a point of concern for the ECB as it could limit the bank's ability to tighten policy meaningfully as the recovery progresses. For this reason already, the current market pricing of 20bp of hikes by December 2022 seems aggressive, however, ECB President Lagarde mentioned herself as well that current market pricing is not in line with ECB analysis. Today's calendar is virtually blank for the eurozone, while many European countries also have a bank holiday due to All Saints' day.

## USD

Friday's session was an interesting one, with the DXY index starting the day close to October's lows just to come roaring back as it broke above the 50-day moving average. The dollar bid was broad based, gaining against all G10 currencies, and with no actual headlines initiating the move it is likely a combination of technical factors and

month-end flows caused for the big turnaround in the dollar. This week's main focus will be the Federal Reserve meeting on Wednesday, where market expectations along with sell-side analyst expectations and recent commentary from policy makers indicate a taper announcement is a foregone conclusion. The current quantitative easing programme consists of \$80bn of Treasuries and \$40bn of Mortgage Backed Securities, and with the Fed already having announced a full stop to the QE programme by June 2022, it looks like a taper of \$15bn divided over \$10bn of Treasuries and \$5bn of MBS is the most likely option for now, with risks of more aggressive tapering being to the upside as the recovery progresses. The speed at which inflation meaningfully recovers to levels closer to the 2% target will be key for any changes to the tapering timeline. While much of the taper announcement is already being priced in by markets, Wednesday's session could see a stronger dollar around the meeting if the taper call is paired with a more hawkish tone around the economic recovery.

## CAD

Following last week's hawkish Bank of Canada meeting, the loonie remains trading near recent highs, but broad USD buying towards month-end reversed all of last week's gains. With oil markets looking as if they've stalled just north of the \$80 mark recently, and equity markets pivoting on whether they post marginal gains, the loonie's tailwinds have seemingly weakened. Another strong labour market reading on Friday could be enough to reignite the recent rally and send the loonie back towards June's highs, but before then, CAD traders will have to brace for an instrumental Fed meeting on Wednesday. Given that the US central bank is set to turn more active and start tightening policy by tapering its QE programme, front-end forward points will be in focus for the USDCAD pairing.

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