G10 FX markets finally wake up to the hawkish Fed minutes

6th January 2022

GBP

The pound starts today's trading session under substantial pressure as European markets open in the aftermath of yesterday's hawkish FOMC meeting minutes. While the release of the minutes didn't disrupt FX markets too much in the immediate aftermath as most of the reaction was funnelled through US equities and fixed income assets, the downturn in risk appetite this morning has coupled with the expectation of higher US rates to result in a delayed USD bid. While Gilt yields have followed Treasuries higher throughout the week, signs that equity markets are going to pay the price upon open this morning has put pressure on risk appetite in the FX space. The pound has currently retraced a large chunk of this week's gains this morning ahead of the final PMI data for December, which is released at 09:30 GMT.

EUR

Mixed economic data from the eurozone has left traders in a wait-and-see approach for euro positions before tomorrow's crucial US payrolls data comes out. Retail sales from Germany were upbeat earlier in the week, while PMI figures from across the bloc disappointed due to new orders and new investment being lower as a result of Omicron fears and mild restrictions. This morning, Germany's factory orders printed well above expectations at 3.7% MoM vs the consensus of 2.3% in November. In Italy, headlines about Prime Minister Mario Draghi potentially eyeing the presidential palace in Rome and departing from the PM office have been unnerving investors as this could create more pressure on Italy or even the eurozone recovery as a whole if it leads to a period of prolonged political uncertainty for Italy, while at the same time the European Central Bank is winding down stimulus. For the remainder of the day, markets will focus on German CPI data released at 13:00 GMT.

USD

US Treasury yields had been rising for the majority of the week as market participants developed higher expectations for inflation and policy normalisation ahead of yesterday's release of the FOMC meeting minutes. The release of the meeting minutes did not disappoint and caused more carnage in equity and fixed income markets as the hawkish expectations were confirmed. The Fed noted, as in the December meeting, that a strengthening economy and higher inflation readings could lead to earlier and faster rate hikes. FOMC participants' discussion around balance sheet reduction was more notable, however, with some members expressing their view that it should start soon after rate lift-off while others flagged the reduction should be more aggressive than in previous times due to the larger accrual of assets and the ample liquidity in money markets this time around. Going into the release, market participants were speculating whether the minutes would show more caution than the December meeting itself, to account for the array of views within the dot plot and the risks brought about by the arrival of the Omicron variant. While the Fed did flag Omicron as a downside risk, the virus didn't stop them from stating maximum employment is within reach and inflation would last longer than initially thought. Initially, FX markets showed a muted reaction to the minutes, with all of the market volatility arising in the Treasury market and US equities, but this morning as European assets reacted to the news, the dollar finally saw a broad bid associated with the hawkish release. A larger repricing in the FX space will likely need confirmation from incoming payrolls data to complete the Fed's hawkish narrative. In that sense, the jobs report will be key in determining whether the growing consensus in money markets for lift-off at March's meeting is the correct bet. Today's calendar will include factory orders and durable goods orders from November, of which the latter is a second reading. Broad USD price action may continue to be volatile throughout today's session, especially when US markets come online, despite the uncertainty posed by Friday's payrolls data.

CAD

The Canadian dollar was one of the only G10 currencies to feel the pinch in the immediate aftermath of the FOMC meeting minutes, with the loonie dropping 0.36% against the dollar over the course of the day. With the rest of the G10 feeling the impact this morning as Asian and European equity markets adjust to the more hawkish rate backdrop in the US, the loonie continues to trade under pressure from the broader market risk-off move despite the TSX already closing nearly a percentage point lower yesterday. With little beyond November's merchandise trade data in store for the loonie today, USDCAD is likely to be driven by the dollar leg and how the greenback trades against the G10 space as a whole, especially once North American markets open for business.