Markets shaken by strong US CPI print while policy expectations grow

11th November 2021

GBP

Sustained dollar strength in yesterday's session following a bumper US CPI report pushed GBPUSD down 1.14%, with price action in GBPEUR less substantive given the driver was broad USD strength, of which placed pressure on EURUSD simultaneously. This morning, a slip in UK Q3 GDP, which printed at 1.3% compared to both the market and Bank of England expectation of a 1.5% print, placed further pressure on the pound, extending losses against the dollar. A break in a key psychological level in EURUSD means that again GBPEUR remains relatively stable despite the big levels being broken in dollar pairs. Today, the focus will remain in front-end bond markets, especially as expectations of higher rates reverberate across G10 markets.

EUR

The euro was no exception to the victim list of the USD strength yesterday and fell to another 15-month low against the dollar in yesterday's session before extending losses further this morning as the US inflation print increased policy expectations for the Fed. In the eurozone, market bets for the European Central Bank raising rates next year also remains high: the 1y1d EUR forward cash rate, a proxy for the market implied policy rate a year from now, still stands at levels last seen in 2014 and prices in at least 25bps of rate hikes for the ECB in 2022. Surging prices are boosting the case for many central banks to aggressively tighten monetary policy, according to market pricing, but the ECB has so far pushed back strongly on market bets for rate hikes. QE is a different story however, and Governing Council member Robert Holzmann even turned to news outlets this morning stating ECB bond purchases could end next autumn, depending on the inflation development. Eurozone bonds were little changed after Holzmann's comments, as he is one of the most hawkish policy makers at the ECB. Other policy makers have been less explicit about the timeline of QE in the eurozone. ECB member Makhlouf, Lane and Schnabel are set to speak today at 09:00, 12:15 and 16:00 GMT while markets will also eye the ECB's economic bulletin at 09:00 GMT. At 10:00, the European Commission will publish its economic forecasts.

USD

Markets were hit by a bout of USD strength in yesterday's session after CPI inflation printed to the upside, igniting further inflation fears globally and expectations of policy tightening by the Fed. October's core CPI rose by 0.60%

MoM, 0.2pp above expectations, while the YoY rate jumped to 4.6%. The annual headline figure rose to 6.3% YoY, the highest inflation reading since November 1990. Annual figures have held less importance recently due to significant base effects, however the strong underlying dynamics of the print are evident across the inflation report as a whole. Yields spiked across the curve while the DXY index rose by nearly a full percentage point on the day. While market pricing of interest rate hikes already is more aggressive than what the Federal Reserve has been relaying, the CPI print places further pressure on the Fed as price pressures are now embedded into the overall economic backdrop given the broad spread of the inflation rise across all categories, forcing markets to question the Fed's messaging again. Today's calendar is empty for the US following a bank holiday.

CAD

No one was safe from the broad USD rally in yesterday's market following the CPI release. USDCAD rallied close to 0.5% as the CPI release reinforced expectations of earlier policy tightening by the Fed, while on the loonie's side, softer crude oil prices following the rising dollar undermined the petro-linked currency further. Despite the fall in crude prices however, both WTI and Brent futures still sit close to recent highs. Today's calendar is empty for Canada following a bank holiday, meaning the loonie will be at the mercy of a recovery in oil prices and general market mood.