Rising US yields prop up the greenback while wrecking the yen

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GBP

Sterling rose 0.7% against the dollar yesterday as higher risk currencies within the G10 widely rallied against the dollar. Given the collective move, we are hesitant to draw too many inferences from the rally and don't believe the GBP move was due to traders adjusting their positions ahead of today's spring budget. This morning, the broader market environment is less supportive of a continued rally in higher beta currencies than yesterday, but the pound continues to trade as one of the better performing G10 currencies against the dollar. February's CPI data out this morning has partially aided the GBP performance, as inflation continues to outstrip economist expectations as headline CPI rose to 6.2% to hit a 30-year high. This comes ahead of the Ofgem price cap adjustment in April, which is set to see headline inflation spike above 8%. Should the inflation data be compounded by further growth supportive fiscal policy measures in today's spring budget at 12:30 GMT, markets are likely to compound their expectations of continued policy tightening by the Bank of England this year. Expectations took a bit of a hit last week when policymakers voted 8-1 in favour of a 25bp hike, signalling that 50bp increments were unlikely in the coming meetings, while the first member of holding rates reared their head.

EUR

A new development in markets became evident at the start of the week when rising US yields on the back of hawkish Fed commentary didn't weigh on the euro as much as it used to do. In recent years, rising Treasury yields mostly affected JPY and EUR as both currencies are sensitive to yield differentials with the US given their central banks' accommodative policy stances. More recently, however, the hawkish pivot by the ECB despite ongoing uncertainties around the Russia-Ukraine war, combined with the inflationary backdrop, have led to market pricing turning more aggressive. Markets are now pricing in around three rate hikes in the eurozone within the next 12 months, as evidenced by the 1Y1D EUR forward cash rate - a widely used proxy for interest rate expectations. This has shielded the euro from further downside against the dollar in Monday's and Tuesday's session and is likely to serve as a backstop for the euro in the months ahead in an environment where US yields are rising. This compares starkly to the Japanese yen, which remains under substantial pressure from rising US yields. The structural break in this relationship is best evidenced in the EURJPY rate, which has risen by nearly 3% since last Wednesday's Fed meeting. With the pricing of monetary policy expectations in bond markets so pertinent for FX pricing as of late, today, FX traders will turn their attention to Bundesbank President Joachim Nagel, who will participate in the BIS conference together with the Fed's Powell and BoE's Bailey.

USD

While hawkish commentary from Fed Chair Powell propped up the US dollar late Monday and Tuesday morning, most gains against the G10 were reversed throughout the remainder of yesterday. The exception to the rule was the Japanese yen, which is more sensitive to higher US rates. The accommodative policy stance from the Bank of Japan already stands in contrast to the tighter stance adopted by the Federal Reserve, and hawkish Fed commentary further emboldens this divergence. This led to USDJPY trading at a fresh six-year high in yesterday's session, which can be a concern for the Bank of Japan given the JPY weakness is only furthering inflation given Japan's position on the wrong side of the energy surge as a major importer. On Tuesday, other Fed officials echoed Powell's words, with even doves like San Francisco Chief Mary Daly now backing robust action. "It's time to remove the accommodation we've been providing", she stated, while Cleveland's Loretta Mester said a 50bp hike should be considered. However, with US equity markets taking the rise in market rates within their stride, commentary from Fed officials yesterday didn't boost the dollar as aggressively as Powell's comments did on Monday, despite the 2-year yield rising by a further 4bps and the 10-year by 9bps. With US equity futures trading in the red this morning, and US yields rising despite flat European yields, the dollar has returned to trade=ing on the front foot this morning, up against all G10 currencies besides the pound, and with more Fed speakers scheduled for today markets will prepare for more hawkishness to come.

CAD

The Canadian dollar appreciated slightly on Tuesday as global markets continued to renew their appetite for risk. Equity markets across the world closed in the green, while the VIX volatility index edged lower. The USDCAD pair has seen diminished volatility in recent days thanks to an economic calendar that's been largely devoid of major catalysts. Bonds provided a marginal boost to the loonie with the difference between Canadian and US front-end yields shifting a few basis points in favour of CAD. Energy prices limited Canadian dollar gains as the West Texas Intermediate index ticked down a third of a percent, while Western Canadian Select sank by 1.67%. Today's calendar is empty for Canada, while the US has February home sales and an afternoon speech from the Fed's Bullard.