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Weekly Report

# Weekly FX Market Update

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Written by:

Enrique Díaz-Alvarez, Matthew Ryan, Roman Ziruk & Itsaso Apezteguia

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# Risk assets rally as markets brace for big central bank week

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Early data on the omicron variant suggests that it's no more virulent than previous variants, and may in fact be less severe.

Risk assets worldwide understandably rejoiced. Stocks, commodities and credit all rallied, helped along by the extremely stimulative settings in both monetary and fiscal policy. Currencies mostly followed suit, with emerging market currencies putting in an excellent performance, and safe-havens underperforming. The dollar fell against most of its peers, somewhat surprisingly.

As central banks in developed countries prepare to dial back the enormous monetary stimulus that is fuelling inflation, there remains large uncertainties over the timing and extent of the removal. The Federal Reserve (Wednesday), the European Central Bank and the Bank of England (Thursday) all meet this week. The Fed is expected to sound hawkish, the ECB dovish and no one knows for certain about the BoE. The interplay between these three institutions decisions, their communications and market expectations for those should be key in what is shaping up to be a decisive week for currency markets.

## CZK

After a muted trading in the first few days of the week the koruna staged a small rally, touching its three-week high against the euro on Friday.

Newsflow from Czechia is quite positive of late. It seems that the recent Covid wave is passing as there is a noticeable drop in the number of new cases: the 7-day moving average declined below 15,000. Economic readings over the past few days have also been largely positive, particularly October's retail sales and recent labour market data. Inflation in November reached 6% and it was the first report since May which didn't surprise to the upside. All in all the data confirms expectations of further monetary policy tightening from the CNB. Those expectations have recently increased again. Nonetheless, further hikes are likely to be much more typical-size increases than the one CNB delivered in November.

This week we'll focus primarily on the outside news. Both the Fed as well as the ECB meetings could have the potential to stir things up a bit, which could also have an effect on the koruna.

## EUR

Strong industrial production data out of Germany last week may have helped the euro stabilise against the US dollar last week, but traders remain focused on the ECB meeting this Thursday. Market expectations are for a very dovish central bank that expresses its willingness to continue buying bonds well into 2022, even as others, particularly the Fed, taper their purchases much faster.

There is, however, some hope for the euro. Any disappointment of these expectations, either through a more aggressive tapering schedule or perhaps the development of hawkish dissent within the ECB, could lead to a sharp short covering rally.

## USD

Inflation in November registered yet another record high, jumping to 6.8% and 4.9% after stripping food and energy components, both fresh multi-decade records. The market had, however, braced itself for these numbers, and currencies did not move much in the aftermath.

A hawkish turn by the Fed this Wednesday is universally expected, with market consensus expecting an end to bond purchases by March and a first hike before the summer. Another key to the meeting will be the "dot plot" in which officials record their expectations for future hikes. Markets are already pricing in three hikes in 2022. If the median Fed member comes in over or under that, it will likely have a significant impact in the dollar.

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Stodolní 9 702 00 Ostrava, Czech Republic

+420 558 080 074 | [info@ebury.cz](mailto:info@ebury.cz) | [ebury.cz](http://ebury.cz)

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