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Weekly Report

Weekly FX Market Update

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Dollar weakness persists as US inflation hits 7%

In a somewhat puzzling development, the dollar is struggling so far in 2022 even as US Treasury yields surge higher and the market prices in a faster hiking cycle from the Federal Reserve.

Last week, the dollar sold-off against every single major currency, save for the Russian ruble, the latter beset by concerns about escalating tensions over Ukraine. The dollar did manage to recover some of its losses on Friday, amid a fresh sell-off in Treasuries, but it is too early to tell if the traditional relationship between rising US yields and a stronger dollar is beginning to reassert itself.

Inflation newsflow continues to dominate financial market sentiment and headlines, including the UK (Wednesday) and Japan (Friday). There are a slew of central bank meetings as well. Data flow out of the US and the Eurozone is quite light this week, but the market will be focused on a key speech by ECB President Lagarde on Friday on the global economic outlook, where she is expected to address mounting market doubts on the ECB's ability to wait until 2023 before hiking rates as inflation surges globally.

CZK

The Czech koruna gave up some of its previous gains last week, selling off against the euro. This can be seen as profit-taking with an additional excuse for it provided by risk stemming from Russia-Ukraine relations after a series of talks between Russia and different organizations including NATO failed to de-escalate tensions. We expect koruna will continue to strengthen further in 2022, albeit the near-term upside potential is limited, in our view.

Contrary to Hungary and Poland where expectations have eased, Czechia's market pricing of hikes didn't change too much last week with the market still expecting an aggressive tightening in the next few months. Considering that as per last week's data core inflation reached 8.6% in December the bank shouldn't hesitate to act.

EUR

In a week without much in the way of meaningful economic data, the euro floated upwards versus the dollar in line with other G10 currencies, a move that we think was driven almost entirely by broad dollar weakness.

This week's schedule also looks rather light, with a significant exception: President Lagarde's speech on the global outlook on Friday. The gap between Lagarde's dovishness on one hand and inflation numbers and market expectations on the other, grows by the week, and we expect her to use this opportunity to address it and clarify the ECB's stance on future interest rate hikes. We expect volatile trading around the speech release.

USD

Even as expectations for US inflation ratchet upwards, the actual data rises even faster. December headline inflation printed 7% (Figure 1), the highest in four decades, and the core data is not far behind at 5.5%, its highest level since the early 1990s.

The calendar this week also looks light in the US, as the Fed enters its quiet period ahead of its next policy meeting on 26th January meeting. The main news so far in 2022 has been the decoupling between rate hike expectations, where the market now expects a total of four hikes in 2022, and the dollar, which continues to struggle against all its major peers.

Figure 1: US Inflation Rate (2012 - 2021)



Source: Refinitiv Datastream Date: 17/01/2022

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