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Weekly Report

Weekly FX Market Update

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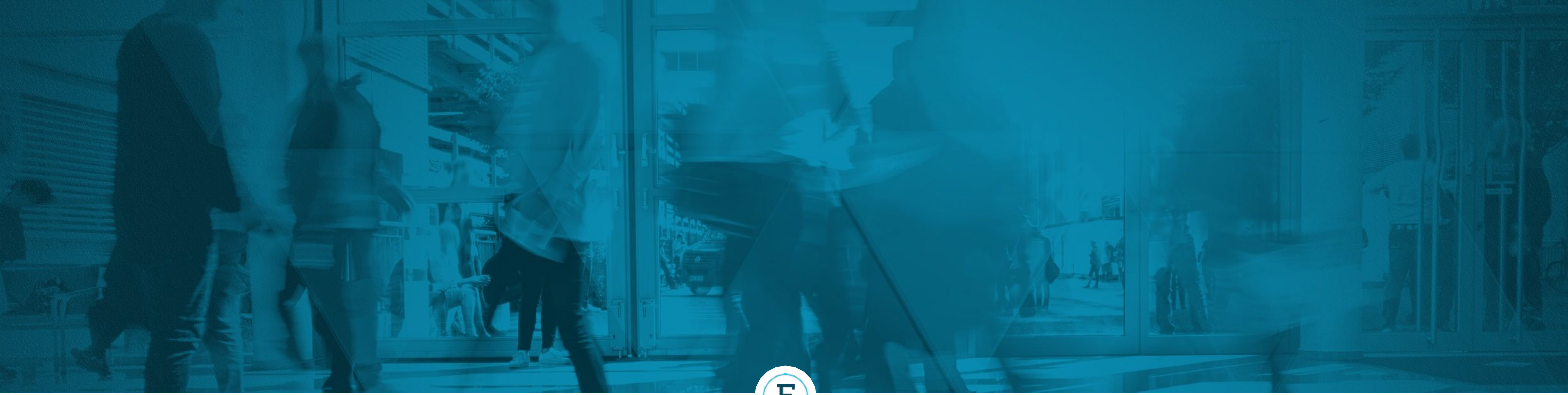


US dollar soars on Fed pivot to fighting inflation

The Federal Reserve made it clear that it is increasingly concerned about inflationary pressures at its December meeting, and the dollar reacted accordingly.

The greenback rose against every G10 currency last week, together with sterling, which joined the dollar rally, as the Bank of England whipsawed markets yet again by hiking rates unexpectedly. Emerging market currencies mostly held up better than G10 ones against the dollar, an interesting development that bears watching closely. The Turkish lira was yet again the exception, crashing by over 15% again as Erdogan's policies threaten to unravel the Turkish financial system.

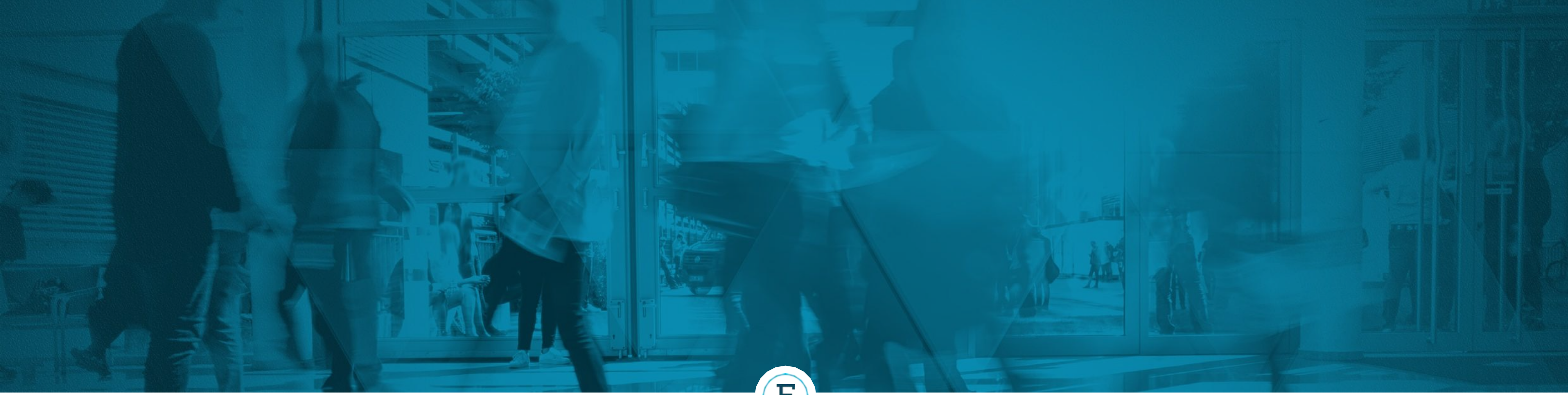
There has been a massive turnaround in central bank priorities over the past few weeks, as shown by the Fed hawkishness, the Bank of England's unexpected hiked rates, and the budding dissent within the ECB council. As the newsflow turns light into the holidays, traders will be paying close attention to the omicron variant news. Into the New Year, the different pace of central bank tightening will continue to be the key driver in currency markets.

CZK

The Czech koruna had a good week, outperforming other regional currencies and rising against the euro.

Economic data from Czechia has been limited of late, but it’s worth mentioning that news on the coronavirus front continues to improve, with the 7-day moving average of new cases declining to approximately 10,000 from almost double that in late November.

This week the Czech National Bank meeting will be at the centre of attention. The bank is widely expected to increase the reference rate on Wednesday, with the consensus penciling in a 75 bp. hike which would take it to 3.5%. We are also leaning towards an increase of this size, although neither a slightly smaller or slightly larger move cannot be ruled out.



EUR

The ECB clearly will lag its global peers in this tightening cycle. However, we think there were subtle but clear signs that the institution is shifting its view on inflation and taking a more hawkish stance.

The inflation forecasts were revised sharply higher. Also, the omicron variant was cited as a potential cause of additional inflation. Finally, President Lagarde suggested the existence of a hawkish dissenting faction within the Council, admitting the decision was not unanimous. For now, however, Lagarde insists that a 2022 hike remains "very unlikely", and the euro struggled to find a footing all week long.

USD

As expected, the Federal Reserve doubled the speed of the taper and will wrap up its bond purchases no later than March. However, Fed communications, notably the "dot plot", were more hawkish than most expected. Fed members now expect to hike rates three times in 2022, and it's clear that the March meeting is now a live one in terms of the possibility of a hike. Chair Powell suggested that the central bank is much more worried about inflation than at the previous meeting, and that it sees the labour market as close to full employment.

While we retain our generally positive outlook on the US economy, one of the key uncertainties is what will happen to US rates once the Fed's massive support for the Treasury market disappears, as bond purchases end on or before March of next year.

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