Dollar falls after fed shifts tone

Market Report 05/12/22 - By Sam Balla-Muir

USD

Jerome Powell rocked currency markets last week by indicating that the Fed would slow the rate at which they increase interest rates. This suggest the Fed thinks that it is inching closer to having done enough to start bringing inflation back down. As a result, equity markets embraced the shift in tone from the Fed with the Nasdaq rallying as much as 4.5% in one day. The dollar index dropped 5% in November, which was its worst month on record since 2010. November's fall in the annualized Consumer Price Index (CPI) figure was the 4th drop in a row, showing that the monetary tightening policy was starting to restrict inflation. The Fed's inflation barometer, the Core PCE Price Index, fell from 0.5% to 0.2% monthly and provided additional further support to the Feds softer position. The latest employment figures from the US, which showed some tightening in labour conditions, also indicate it may be time for the Fed to slow down on its rate hikes. Private sector employment fell from 239K to 127K, while the Non-Farm Payrolls (NFP) figures showed a slight increase in the average hourly earnings and a lower-than-expected addition to public sector jobs. Providing that the US economy continues to show signs that it is recovering against inflation, then I suspect the likelihood is that the dollar will continue to weaken over the months ahead. The impact this has against both GBP and EUR will be dictated to a greater extent by what takes place in these economies.

GBP

Excluding the GBP/USD pair, most sterling crosses remained stable over the last week highlighting there was not a huge amount of movement in the pound. One of the key data releases of note was the Nationwide Building Society house price index which confirmed that house prices fell 1.4% over the last month, the largest decline since the start of the Pandemic. This is a telling indicator of the UK economy as waning demand for property can be attributed to the higher borrowing costs in combatting inflation. Despite the pound rallying to 24 month highs against the dollar, 25/25 analysts polled by Bloomberg are anticipating the levels to drop off by the end of March 2023. On the other hand, the key factor in what could allow the pound to extend gains against the dollar and go against analyst expectations is risk sentiment. As equity prices start to go back up and protests across China are prompting an easing in lockdown restrictions, this could limit the downside risk for the Pound against the dollar. The main driver over the months ahead will be to what extent the Bank of England has a handle over inflation and how far they need to go in increasing interest rates.

EUR

It was a mixed week for the EUR last week, strengthening 2.2% against the dollar however weakening 0.3% against the pound. We saw inflation slow slightly according to preliminary figures released on Wednesday. The report highlighted a 0.6% fall from October in the previous year. The key driver of this metric is likely to be the cost of energy which has already increased 34.9% over the last year. This mere reduction will give the ECB some comfort in their battle against inflation rates. As a result, analysts are now favouring a 50bps move instead of 75bps which is a good sign that inflation is getting under control despite Christine Lagarde suggesting earlier in the week that inflation has not peaked yet. If this trend continues then I would expect the EUR to strengthen against both the pound and dollar. The EU have levied a boycott on Russian oil and implemented a price cap of £49. It was anticipated OPEC might have looked to cut production again to stem dwindling oil prices however it was announced yesterday that production will remain unchanged which will all things being equal this should stabilise the price of oil for the foreseeable future and add less pressure to energy prices.

The Week Ahead

The Week ahead is a relatively quiet one in the US with PPI & ISM service data of only real significance. As for the euro, GDP data and regional retail sales make up the most important data releases to look out for. Whilst in the UK, it is a very quiet week for data with the most notable event being the British Retail Consortium’s Like-For-Like Retail Sales on Tuesday.

Last Week's Changes In Exchange Rates

Exchange Rate%- change on week

$ per £	+ 2.20
$ per €	+ 2.20
€ per £	+ 0.30

Key Events

Date	Market	Time (GMT)	Release/Event	Period	Previous	Analysts’ Expectation
Mon. 5th	US	15.00	ISM Services PMI	Nov.	54.4	53.5
Thu. 8th	EU	12.00	ECB President Lagarde speaks	Nov.	-	-
Fri. 9th	US	13.30	PPI m/m	Nov.	0.2%	0.2%