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Fiscal stimulus remains the key focus for the markets

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USD: Biden's package advancing

The US dollar has rebounded modestly and the risk-on tone of recent days has reversed somewhat. With a lot of Asia closed for Chinese New Year trading conditions were not at usual levels. Japan markets traded today but were close to unchanged. The standout headline that may explain the slight underperformance of AUD was that Melbourne, where the Australian Open tennis is being played, is entering a snap five-day lockdown after an outbreak of the highly infectious UK strain of COVID. Melbourne in Australia's 2nd most populous city and experience in general points to such short lockdowns not having the desired effect, so risks are high that this could turn into something more serious. AUD/USD reaction so far has been quite modest so there are certainly short-term risks the drop could extend further.

But the key global macro focus for the markets will remain the signs of progress of the fiscal stimulus package in the US. Developments this week certainly point to the prospect of President Biden's USD 1.9trn package remaining more intact than previously assumed and possibly getting legislated in quicker time. Yesterday, the House Ways and Means Committee approved measures providing USD 594bn in benefits included in Biden's bill covering the USD 1,400 stimulus cheques plus

US 5-YEAR REAL YIELD HITTING FRESH RECORD LOWS

Source: Macrobond & Bloomberg

advance tax credits for children. These components were passed along party lines in a 24-18 vote. Twelve different House committees are working to clear different elements of the package with an aim to vote on the full package during the week of 22nd February. This would increase the prospects of House Speaker Nancy Pelosi's target of legislating the stimulus package by mid-March, when the current temporary lift to jobless benefits expire.

Stimulus cheques was one area we thought would probably be caught for compromise so the fact that it has passed the Ways and Means committee is a sign that this component and the overall package will be larger than what the markets were assuming just a few weeks ago. The USD 15 p/hr minimum wage legislation has also been pushed through the committee stage but it remains unclear whether that will survive in the Senate under budget reconciliation.

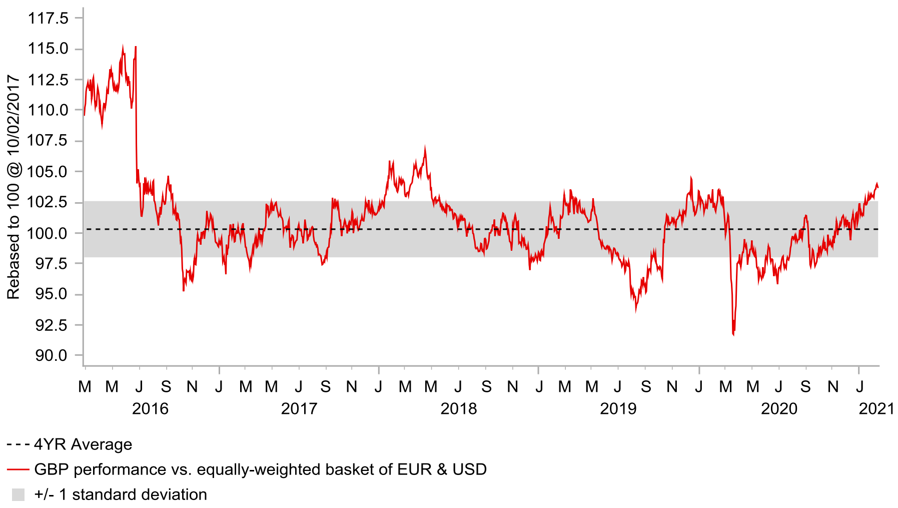
Still, we are clearly headed for a larger package than assumed just a few weeks ago which is set to ensure the momentum behind the global reflation trade is given a further lift. When this is coupled with the strong communication from Fed Chair Powell this week on maintaining the current aggressive policy easing, we expect this mix to keep the US dollar on a weaker footing over the coming weeks.

GBP: UK-EU trade frictions a downside risk

It is becoming increasingly clear that the Northern Ireland Protocol, agreed as a way to unlock the Northern Ireland border problem in the Withdrawal Agreement, is having serious teething problems and is not working in reality on the ground. Yesterday, Michael Gove met with European Commission Vice President Maros Sefcovic in London to discuss the problem. The talks were described as "frank but constructive" although there was no indication any progress was made.

At the heart of the problem is the belief in Brussels that the UK is effectively refusing to implement the agreed measures controlling the flow of goods between Northern Ireland and the rest of the UK.

GBP AT ELEVATED LEVELS



Source: Macrobond & Bloomberg

This souring of relations over a deal that has only just gone live could certainly complicate making progress on other key aspects on the services side of trade that still need to be agreed. The EU this week warned that reaching any deal on financial services and equivalence may take a considerable period.

At present there has been limited financial market reaction to the worsening relations but there are clear risks that it could escalate and become a financial markets issue – certainly an issue that could thwart the recent upward momentum for the pound. But the positive aspect from this meeting was an agreement to meet businesses in Northern Ireland in order to hear the real issues and then assess how these can be resolved.

This development should at least dial down the tensions that have been building in part by the poor EU decision to threaten border controls in Ireland to ensure controls over the export of the COVID vaccine. We maintain our positive GBP view for now but will monitor closely how this consultation period proceeds over the coming days.

KEY RELEASES AND EVENTS

Country	GMT	Indicator/Event	Period	Consensus	Previous	Mkt Moving
SP	08:00	CPI MoM	Jan F	0.1%	0.1%	!
SP	08:00	CPI EU Harmonised MoM	Jan F	-0.3%	-0.3%	!
SP	08:00	CPI Core MoM	Jan	--	0.00%	!
CA	13:30	Wholesale Trade Sales MoM	Dec	-1.7%	0.7%	!
US	15:00	U. of Mich. Sentiment	Feb P	80.8	79	!!

Source: Bloomberg

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