FX Daily: Looking for yield, wherever you can get it

FX markets will be quiet ahead of the main event this week - Wednesday's FOMC meeting. But we'll also see rate meetings in Norway, Switzerland, Brazil, Turkey, Indonesia and Taiwan. Barring a hawkish surprise from the Fed, expect a continued search for yield. This interest is increasingly spreading to select EM local currency bond markets.

USD: Steady into Fed

The highlight of the week will be Wednesday's FOMC meeting. See our full preview here. Our preferred view is that the statement, projections and press conference will not interfere with the core summer trend of a search for yield amidst a broad, cross-market decline in volatility levels. Indeed, FX reserve managers occasionally add to these trends in FX markets by collecting options premia in order to enhance yields on their low-yielding bond portfolios.

The above is very much a consensus view now. Meaning that Wednesday is a genuine event risk should the Fed feel comfortable enough to bring tapering talk to the table.

The search for yield is very evident in bond markets and has no doubt caused a lot of pain for paid rates positions. The long end of the US Treasury market is the prime example, but on Friday we also saw big declines in yields for both Italian and Greek debt, where 10 year spreads may trade inside of 100bp to German Bunds.

The rally in local currency bond markets is also evident in EM as well, where Russian 10 year bond yields fell 11bp after a hawkish 50bp rate increase from the CBR. In fact, it seems flows into EM local currency bonds are the strongest since the first week in February and see investors rewarding those currencies, where local central banks are prepared to undertake front-loaded tightening to see out the inflation spike. This is very much the case in Brazil, where BACEN is expected to hike another 75bp this week.

Our point here is that the search for yield, which is extending into EM bond markets, is probably a slight dollar negative and is a trend that could build should Wednesday's FOMC pass without fanfare. For today, Chinese and Australian holidays have delivered a quiet overnight session and the question is whether a market, short dollars, wants to take a little risk off the table before Wednesday's event risk. Above 90.60, DXY could see a modest correction to 91.00 before the FOMC.

EUR: Casting across the European monetary spectrum

As we discuss in our G10 FX Week Ahead, Europe sees policy meetings in Norway and Switzerland this week. Norges Bank sits firmly at the hawkish end of the spectrum and SNB at the dovish. Indeed, the market will look at the SNB's weekly CHF deposit data to see if the SNB has picked up FX intervention after EUR/CHF traded below 1.0900 last week. We think the differing monetary stances should be enough to send EUR/NOK lower and EUR/CHF higher this week.

EUR/USD remains trapped in the middle amidst two central banks happy to keep on printing. Look out for ECB speakers in the form of Schnabel and De Cos today. Let's also see how far those rallies extend in Greek and Italian sovereign bonds. We see EUR/USD range-bound into Wednesday, although bulls like ourselves would prefer to see a daily close above the 1.2130 area - just to reduce the risk of that $ short squeeze into Wednesday.

GBP: No surprises about lockdown delay

UK media is widely reporting that the UK government will formally delay its 'day of freedom' on June 21st by four weeks. We do not think this does too much damage to GBP, which instead will be focused on fresh macro updates on jobs and retail sales - both expected to be GBP supportive.

Also look out for comments from BoE Governor, Andrew Bailey. He speaks at the Association of Corporate Treasurers at 15CET today and has been more towards the upbeat end of the monetary spectrum. This comes at a time when the market looks to be pricing the first 10bp BoE hike in 4Q22 - well ahead of the Fed. 1.4020 is the risk today for Cable on a little $ short covering, but EUR/GBP could break important short-term support at 0.8565 should Bailey repeat upbeat comments.

TRY: Geopolitics in focus

The search for yield seems to have extended to the TRY - which was the EM world's top performer last week. 18% implied yields are naturally attractive, but the TRY's intense volatility is not.

For the short term, the focus is on: i) Biden meeting Erdogan on the sidelines of a NATO summit today, ii) Turkey announced it has increased FX swap line with China by $3.6bn to $6bn and iii) Thursday's CBT meeting where rates are expected to remain on hold at 19%.

Given the frequent bouts of volatility in the TRY, investors may not be bold enough to drive USD/TRY down to the 8.00 area - but never under-estimate the search for carry if external conditions stay benign.

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