

## FX: A dead cat bounce?

Markets are breathing a sigh of relief. But is the correction over or will this recovery prove to be short-lived?



Source: Shutterstock

### USD: End of stock market correction or 'dead cat bounce'? History says former

Global markets are breathing a huge sigh of relief after a late rally in US stocks yesterday helped to engender a sense of stabilisation in the Asian trading session overnight. The number one question investors will be asking themselves now is whether this draws a line under the recent stock market correction or whether this is merely a 'dead cat bounce.' Analysing prior episodes of sharp, unexpected VIX spikes – of which we identified seven instances since 1990 ([see A history of VIX spikes in three charts](#)) – it seems that technical 'flash crashes' are often followed by a more sustained period of consolidation after the initial sell-off if there are no fundamental (macro or geopolitical) reasons to send stock markets lower again. Given that the current global economic backdrop draws greater parallels to that seen during the August 2015 stock market sell-off – as opposed to say the May 2010 flash crash – one is inclined to tentatively conclude that some respite is likely. However, the US government staying open would certainly help extend any consolidation mode in risky assets – and with President Trump threatening a shutdown if the budget did not include any immigration legislation, it remains highly uncertain whether Congress can strike a deal before the US government runs out of money again on Thursday. The House did

pass a stopgap spending bill to extend funding until March 23 – meaning the onus is now on the Senate to make amendments before sending to the White House for final approval. In any case, given the relatively muted contagion effects from the current stock market sell-off to currency markets, we think it is only a matter of time before we revert back to the weak US dollar trend.

## **EUR: Look for modest upside above 1.24 if global risk sentiment stabilises**

A fairly quiet day for G10 data releases means that we expect some lacklustre moves in major currency pairs today. EUR/USD to trade sideways around 1.24.

## **GBP: Sharp move lower not due to Brexit-related risks**

The pound has fallen quite substantially for three consecutive days now against both the USD and EUR – a feat that since the referendum has usually coincided with periods of heightened ‘hard’ Brexit risks. While there is certainly greater noise and uncertainty surrounding a transition deal – and tough talks between UK and EU officials – we believe Brexit dynamics have not been the driving force behind sterling's latest corrective move lower. While a more hawkish tilt from the Bank of England tomorrow may not be (a) obvious and (b) result in material GBP upside until a Brexit transition deal looks more definitive, we are still targeting 1.45 in 1Q18 as the UK economy regains some of its cyclical swagger.

## **BRL: Central bank a secondary driver for the real; focus on Congress reforms**

Ahead of Brazil's central bank meeting today, ING's chief LATAM economist Gustavo Rangel notes that a wide-range of economic indicators are displaying stronger signs of a rebound in economic activity in Brazil. However, this shouldn't stop the central bank from cutting the policy rate at least once more today – which would take the SELIC rate (overnight rate) to 6.75% (in line with consensus).

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