FX Armageddon

If cash is king, then dollar cash currently is world president. Everything that could be sold was sold against the dollar. We'd be foolish to argue that this can turn around anytime soon – perhaps not until new Covid-19 cases start to slow. We may start to hear talk of intervention in FX markets – at least an attempt to calm disorderly markets, if not weaken the $

Who said volatility was dead?

Despite some large-scale measures to address dislocation in USD funding markets, the dollar advance has not slowed. Instead, it has accelerated in a disorderly fashion. 4%-7% moves in the dollar against the likes of GBP and NOK are extremely rare. One-week implied volatility in the $/G9 pairs are in the 15-25% range, $/NOK at 40% – a new all-time high.

The moves smack of massive de-leveraging and a run into dollar cash – bearing all the hallmarks of a massive margin call on the whole financial asset market rally since 2010. There will be plenty of those out there saying 'I knew this would all come crashing down'.

Macro-fundamentals have little bearing on current FX moves – and indeed there are probably a lot of undervalued currencies out there now. But only this de-leveraging has run its course, there is no point trying to be clever and pick the low.

The only relative value which makes some sense today is the massive sell-off in oil-linked currencies, where NOK and RUB are both off 8% against the dollar – the former not helped by poor liquidity conditions as we discussed earlier.

Disorderly markets = FX intervention?

Today's FX market moves are without doubt disorderly. Typically, G7 Central Bankers – if they were coordinating – would be on the phone right now to discuss what is to be done. Might they issue a statement – similar to typical Japanese MoF statement – that they are watching markets carefully and are prepared to act?

If they did act, what would they do? Clearly, if there is one currency causing problems right now and aggravating the sell-off in global asset markets, it is the US dollar. Co-ordinated FX intervention to weaken the dollar? Another Plaza accord? Right now, it is hard to see the ECB or the BoJ buying into co-ordinated FX intervention to strengthen their own currencies in a deflationary environment. Although at some point the ECB might be less averse were the weak EUR to be adding to a sell 'Europe' story.

The biggest fans of FX intervention will be the White House. We've discussed this last year. But with the trade-weighted dollar now going to an all-time, maybe the US Treasury does want to press the button. If so, it would be dollar sales against EUR and JPY – the two currencies they hold in the Exchange Stabilisation Fund. They could also argue that they are providing the market with some much-needed dollar liquidity!

Dollar trade weighted index surges to a new all-time high

Source: Bloomberg

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Disclaimer