

FX Daily: All aboard the dollar boat as waters get rougher

Yesterday's correction was partly driven by some re-pricing of the reflation story. Today, the FOMC June minutes will be watched closely as markets may start to get concerned about the Fed going ahead with tightening even if the recovery is uneven. OPEC+ drama may keep inducing oil volatility and commodity FX weakness may linger, while the USD may stay bid



⬆️ USD: Hard to turn bearish now

Markets have stabilized overnight following a pure risk-off trading session yesterday, which translated into yet another round of dollar strength in FX, mostly against commodity currencies (and especially those sensitive to oil), with only the safe-haven yen gaining ground. Three main factors have contributed to the risk correction yesterday, and are set to remain key threads today: a) the sharp drop in oil prices, b) a weak ISM reading spurring fears of a slower recovery, c) China's crackdown on tech companies listed abroad.

On the first point, markets clearly moved from a situation of short-term output-related uncertainty to a longer-term concern about the stability of the cartel's deals yesterday. The drop in oil prices is

likely factoring in some risk of a fully-fledge breakdown in the current output deal that may trigger a cascade drop in compliance and excessive supply. Markets will likely need to hear more encouraging signs that OPEC+ members are indeed moving towards a reconciliation to see a stabilization in prices.

On the second point, concerns about a slower recovery after the grim non-manufacturing ISM reading yesterday are inherently tied to Fed's rate expectations, and some investors may start to feel the danger of a Fed that will have to go ahead with its tightening cycle in 2023 even if the economy is in a more vulnerable state than currently expected. The FOMC June minutes are therefore set to be watched closely today, with markets weighing carefully the rationale behind the hawkish shift by policymakers.

On the third point, markets are seeing the tough stance by China on foreign-listed tech firms as a potential first step towards a larger confrontation with the Western economies on technology. This has been a rather muted risk during the pandemic period, but a resurgence may prompt some risk-premium built-up in some exposed currencies (such as the antipodeans in G10).

With all this in mind, we think the market will continue to lack reasons to turn bearish on the dollar for now, especially given the risk of a second round of Fed's hawkishness spill-over into the market coming from the FOMC minutes. OPEC+ dynamics will dictate the direction for oil-related currencies, but high-beta FX may keep struggling today as a whole as sentiment remains unstable, while the likes of JPY and CHF may keep benefitting from some unwinding of the global reflationary story.

⬇️ **EUR: A break below 1.1800 looks near**

The EUR appears to be mostly a bystander among the swings in the dollar. While being protected from the oil-price volatility, the EUR is lacking idiosyncratic drivers at the moment. With the dollar not very likely to invert its bullish trend today – in our view – EUR/USD may gain more downside momentum if the psychological 1.1800 support is broken today.

⬇️ **GBP: Cable may follow EUR/USD lower**

The UK government's decision to go ahead with a further easing of restrictions on 19 July has endorsed the market's relatively relaxed stance towards the recent flare-up in Covid-19 cases in the country, and marginally helped sterling contain the downside stemming from a stronger dollar. Ahead of a speech by Andrew Bailey and some industrial output data on Friday, GBP is left without other domestic drivers, and Cable may follow EUR/USD lower today, making a more decisive move below 1.3800.

⬇️ **NOK: Suffering from its high betas, but fundamentals are not weak**

The Norwegian Krone continues to be the worst-hit currency during risk corrections, and is now down 5% (worst performing in G10) against the dollar in the past month. Indeed, the Krone is suffering from having the highest beta in G10 to global risk appetite and high exposure to the fall in oil prices. More NOK weakness may be on the cards today as we expect some more choppy sentiment and dollar's strength, and the oil market that may stay vulnerable until a new deal is reached or a new meeting set. Still, looking beyond the short-term, NOK can still count on the most hawkish central bank in G10, decent domestic economic performance, and crude prices that –

even after the correction – are set to keep underpinning the recovery of the Norwegian oil sector. A stabilization in risk sentiment in the coming weeks may see NOK emerge as an attractive buy-the-dip opportunity in G10.

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