

FX Daily: A black black Friday

Market sentiment has been hit by the news that a new Covid variant is spreading in Southern Africa. While we await more information on the new strain, the oversold JPY is getting a major lift and pro-cyclical currencies are dropping. As the US market returns for half a day of trading, we could see more risk-off trades in FX



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➔ USD: All focus on the new strain

Yesterday's closure of the US markets for Thanksgiving caused most FX pairs to trade within very tight ranges. Today, markets will reopen but only for half a day, and should see another fairly low-volatility session today.

The general environment in FX remains quite supportive for the dollar, as the FOMC minutes and a bunch of good data kept market speculation on faster tapering and earlier tightening alive. On top of this, the worsening contagion situation in Europe and risk of fresh containment measures are generating further divergence in policy expectations between the ECB and Fed.

Overnight, we saw the highly oversold yen gain nearly 1% against the dollar while pro-cyclical currencies followed global stocks lower after the concerning news about a new Covid variant that appears to have the biggest mutation seen so far. The most notable previous Covid variants proved, in general, to be also more transmissible and more lethal than the first Covid strain, and scientists are attempting to evaluate whether this is the case as well. At a very early stage, the

evidence seems quite concerning.

The variant has been identified primarily in South Africa, and multiple countries are rapidly blocking all flights to the country, as well as other African nations. The rand is unsurprisingly a major underperformer, having dropped to one-year lows and still looking quite vulnerable.

More information on the variant will be needed, but it looks like it is indeed going to be a very “black” Friday for global risk sentiment. JPY and CHF should remain a favourite choice as safe-haven hedges above the dollar, which should however remain supported against all the pro-cyclical bloc. NOK, AUD and NZD appear particularly at risk.

➔ EUR: Holding above 1.1200 for now

The Covid crisis in Europe has deepened this week, as rising cases across the continent saw another low-vaccination country – Slovakia – announce a full lockdown. The key question remains whether the highly immunised countries like France, Italy and Spain will manage to weather this virus wave without ultra-strict measures. For now, the approach has mostly been focused on applying tougher restrictions on non-vaccinated individuals and speeding up the rollout of third doses, although discussions about potential restrictions around Christmas are mounting in local governments.

We see the euro as still vulnerable due to the Covid situation in Europe which, as highlighted above, is further widening US-EZ rate expectations. Given overnight developments, a major question now is whether the new variant has already reached Europe (which is geographically closer to Africa). This could deal another blow to EZ sentiment and the EUR, which otherwise seems to have marginally benefited from its low-yielding status as the new variant shook markets and may hold above 1.1200 into the weekend.

We have heard some ECB members this week indicating that PEPP will end in March: we’ll see whether the many scheduled speakers (including Christine Lagarde and Philip Lane) for today will touch on this subject again. Still, the EUR has been quite unreactive to policy comments with most of the focus on the current Covid-related re-rating of EC growth expectations.

⬇ GBP: Is the UK more exposed to the new variant?

The UK rapidly imposed restrictions on flights from some African countries yesterday as the new variant started to cause major concerns. London is naturally highly exposed to new strains given its high volume of travellers, and markets will be on the lookout in the coming days for any evidence the new variant has already reached UK, with obvious downside risks for the pound. For now, EUR/GBP has moved higher and may remain supported today, mainly due to the pound’s higher sensitivity to risk sentiment than the EUR, but also as the story of EU-UK divergence in terms of severity of the virus situation is inevitably being challenged by the new variant.

Domestically, we’ll hear from the Bank of England’s Chief Economist Huw Pill, who will deliver a speech of the economic outlook. Yesterday, Governor Andrew Bailey claimed that that rate guidance is “hazardous” for central banks, and it seems likely that the Bank is trying to steer away from the kind of misleading communication we saw in the run-up to the November meeting.

We remain in the view that the BoE will hike on 16 December, which should ultimately put a floor under GBP into year-end – barring a material deterioration of the Covid situation in the UK.

SEK: External factors simply matter more than the Riksbank now

Yesterday, the Riksbank took two [tentative steps to tightening](#) – first, by introducing a hike in its rate forecasts (a 20bp increase in 2024), then by signalling they could start shrinking the size of their balance sheet in 2023. Given the previous reluctance of the Bank to signal any kind of tightening in the forecast horizon, the move was a hawkish surprise even if it did not come anywhere close to the market's tightening bets, which are now for 40bp in 2022 and 40bp more in 2024.

The impact on SEK proved quite contained and short-lived, which is not too surprising considering that: a) there is no real room for further tightening being priced in; b) external factors seem to matter more for the krona now. Despite Sweden not suffering from a particular spike in cases, SEK is highly sensitive to global risk sentiment and in particular, the eurozone's growth expectations (as most of Sweden's exports are intra-EU). External drivers should remain dominant for SEK in the coming weeks and the risk is that – despite the krona having a positive seasonality in December – we could see a EZ growth re-rating capping the recovery.

We are currently forecasting 10.00 at the end of December, but given the worsening of the virus situation in Europe this is increasingly looking too optimistic for SEK.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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