FX Daily: Another virus scare

An outbreak of the coronavirus in China threatens to curtail travel, transport and retail sales just before the Chinese Lunar New Year travel season and stands to dent some of the new-found optimism in Asia after the US-China trade détente

People crossing a Shanghai road

USD: Focus on new virus scares Asian equities

Short term focus today turns to developments in Asia where an outbreak of the coronavirus in China recalls the events of the SARS virus in 2002-03. News that this can be spread human-to-human comes just before the Chinese Lunar New Year travel season and stands to curtail travel, transport and retail sales. The SARS episode largely impacted Asia, although did spread to Canada, and now stands to dent some of the new-found optimism in Asia after the US-China trade détente. Asian FX weakness may provide a little strength to the dollar and could keep DXY well inside a 97.10-97.80 range.

EUR: Trump-Macron digital tax deal is encouraging

One of the trade threats this year was Washington switching its attention to European trade surpluses. News overnight that Presidents Trump and Macron have agreed to avoid escalating tariffs over the French digital tax initiative is a sign that Washington may not want to address European imbalances until after the election. Expect EUR/USD to remain rangebound, unless an equity correction prompts a squeeze in short euro positions. EUR/USD to trade 1.1075-1.1135/50.

GBP: Jobs data another piece in the BoE rate cut puzzle

Expectations of a January 30 Bank of England hike (67% probability priced) receive two inputs today in the form of: (i) jobs data and (ii) a 16CET speech by Mark Carney in Davos on growth. The jobs data is widely expected to show a slowdown in earnings, but a pick-up in employment (3m/3m change.) So far, the BoE easing story has had little impact on GBP speculative positions, suggesting resilience amongst this community and a view that today's employment data would have to be very soft to elicit a big GBP reaction. Still, with Carney later, cable risks 1.2900.

JPY: BoJ upgrades growth, cuts inflation forecasts

At its policy meeting today, the Bank of Japan updated its growth forecasts for FY 2020 to 0.9% (0.7%) and 2021 to 1.1% (1.0%), while cutting its inflation forecasts marginally as well. There is very little expectation it will change its policy of QQE and Yield Curve Control anytime soon. One-year implied volatility for USD/JPY recently hit an all-time low at 6% and most (ourselves included) expect the Japanese yen to retain its funding currency status through 2020. Expect USD/JPY to stay supported in the near term, though we are watching the decline in US dollar hedging costs for Japanese investors – these have fallen to 1.97% p.a. (using 3m forwards) versus a peak of 3.4% in late 2018. Were these costs to fall much further, e.g. another 50-75 basis points, Japanese investors could raise USD hedge ratios, depressing USD/JPY. For now, however, expect USD/JPY to stay supported.

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