FX Daily: Bonfire of the low yielders

The rise in bond yields has not been quite sharp enough to trigger a tipping point in global equity markets but we are seeing speculative dollar shorts getting unwound against the low yielders. Still, we see this as a corrective dollar rally – not a turn in the bear trend

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USD: Bracing for another week of bond stress

It is fair to say financial markets are going through a period of correction, largely triggered by the sharp rise in US Treasury yields. As we discuss in our G10 FX Week Ahead, a variety of inputs into the US Treasury equation such as CPI/PPI updates, passage of the $1.9trn US stimulus plan, plus 10 and 30 year auctions pose upside risk to Treasury yields this week. The rise in yields has not been quite sharp enough to trigger a tipping point in global equity markets – we're more seeing a rotation out of Tech and into Financials – yet we are seeing speculative dollar shorts getting unwound against the low yielders – first Japanese yen, then Swiss franc and now it looks like the euro. Other currencies in the G10 complex backed by commodities – especially oil – have withstood the correction far better. For example, Norway's krone and Canada's dollar are largely unchanged against the dollar over the last week. This trend looks likely to continue this week – especially with Brent now trading above $70/bl after the weekend attacks on Saudi infrastructure. Indeed, the spike in oil also plays into the inflation narrative and the need for a larger term premium to be priced into bond yields. Yet we do see this as a corrective dollar rally –

not a turn in the bear trend – and would be looking for it to stall after a 1-2% extension higher. We're calling DXY to 92.50 this week.

EUR: Look out for ECB's APP report today

As above, the low yielders look vulnerable to the rise in the dollar and we think EUR/USD can drop to its 200-day moving average near 1.1825 this week. For today, look out for the release of the ECB's Asset Purchase Programme report, detailing the volume of bond purchases under its Pandemic Emergency Purchase Programme in the week to last Wednesday. Last week's report of just EUR12bn disappointed, versus a prior average of EUR17bn. Presumably any sharp pick up in purchases could limit the rise in eurozone bond yields. What this may mean for the the euro is unclear, but probably slightly negative in that it would represent a more interventionist and worried ECB.

GBP: A relative outperformer

Sterling continues to perform quite well, buoyed largely by the vaccination rollout success – today embodied by UK schools returning to the classroom. Europe is still struggling with the vaccine rollouts and lockdowns- the new case rate in Italy, in particular, looks to be heading in the wrong direction. Look out for a speech by Bank of England Governor Andrew Bailey at 11CET today. EUR/GBP could make a move on 0.8550.

CNH: Corrective dip

Like many USD crosses, USD/CNH is undergoing a correction, but we suspect it will stall in the 6.55/60 area. China reported strong trade volume data at the weekend and given our bullish outlook for 2021, the current rally looks a good opportunity to position for levels near 6.20/6.30 later this year.

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