FX Daily: Calmer financial conditions coming?

Leading indicators of equity volatility are back to levels last seen on 11 March, Asian markets are up and Dow futures are called markedly higher on hopes that the number of coronavirus cases is starting to plateau

USD: Equity volatility finally showing signs of sinking

Asian equity markets are slightly firmer overnight on signs that steep Covid-19 trajectories are starting to flatten slightly – albeit at a time of huge human cost. Leading indicators of equity volatility, such as the VVIX in the US, are dipping back to levels last seen on 11 March and Dow futures are called +700 pts higher. For this week, the financial market focus will again be guided by the fate of oil – where the emergency OPEC+ meeting has been postponed to Thursday. Our team believes it will be difficult to strike an agreement, warning that oil could easily give up a large part of last week's gains and undermine stabilising risk sentiment. Elsewhere this week we will be focusing on whether the various Federal Reserve and US Treasury schemes can bring some calm to US money markets – 3m USD Libor dropping to 1.15/20% would be a welcome sign. It is going to take some time for the dollar to turn lower, but with the Fed balance sheet having already grown US1.6 trillion over the last four weeks, the dollar looks unlikely to hold onto recent gains. DXY may struggle to break 101.00/101.20.

EUR: Tuesday’s Eurogroup meeting looks key

Now that the European Central Bank seems to have peripheral European debt markets under control, the focus shifts to the collective political response. Key here will be Tuesday’s Eurogroup meeting. The FT today reports that Germany’s resistance to Coronabonds may be starting to soften, although any agreement on this issue tomorrow looks premature/would be a major surprise. FX implied volatility levels are still very elevated, but with realised volatility starting to drift a little lower, some sense of calm may be returning to FX markets. EUR/USD held support at 1.0770 on Friday and we still prefer a drift higher here through the week.

GBP: Consumer confidence plunges

News that Prime Minister Boris Johnson is in hospital and that March consumer confidence has already plunged back to 2008 levels have hit sterling today. GBP looks cheap against the dollar, however, and given the speed of the recovery from 1.15, we suspect that investors and corporates will see good value in cable should it get anywhere near 1.20 again.

MXN: Struggling

As we’ve been mentioning recently, there are some currencies that have failed to show any signs of recovery recently. The Mexican peso and South African rand are the standouts, both with fragile debt positions. At the weekend, Mexican President Andrés Manuel López Obrador's (AMLO) stimulus package failed to inspire – perhaps because of fiscal constraints -and MXN is today trading at a new low. The legacy issues of debt downgrades (Mexico) and the threat of defaults/IMF bailouts (ZAR) will stay present.

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