FX Daily: ECB keeping the euro safe

The European Central Bank's expected €500 billion top up to its pandemic asset purchases today should have a further stabilising effect on the euro

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USD: Pausing for breath

Following its material broad-based decline in recent days, the US dollar's fall stalled overnight. The reflation trade and US Treasury yield curve steepening has been the key driver of FX markets over the past days and weeks, leading to a weaker USD and an impressive rebound in cyclical currencies (both in the G10 and emerging markets space). For now, FX markets seem to be pausing for breath but the weaker USD story still remains a key theme for the rest of the year.

EUR: The ECB's PEPP top up to have a further stabilising effect

The major focus of the European Central Bank meeting today is on the extension of the Pandemic Emergency Purchase Programme asset purchases. As per our ECB Crib Sheet, the expected €500 billion top up to the PEPP should have a further stabilising effect on the euro, keeping the currency's risk premium in check (the latest larger-than-expected German fiscal stimulus is also beneficial for EUR). But as this is largely expected, one should not expect much beyond the stabilising effect for now, particularly when EUR/USD trades modestly overvalued on a short-term basis. The short-term overvaluation may temper any meaningful EUR/USD upside even if the ECB surprises with a more forceful PEPP response (ie, €750bn expansion vs €500bn expected). Any meaningful EUR/USD gains would likely stem more from a USD bear trend (our base case for 2H20) rather than further ECB risk premia containing measures (as EUR risk premia has been already supressed and more from the ECB is already expected). EUR/USD to stay below 1.1300 today.

GBP: Few reasons to be cheerful

The limited prospects for progress of the UK-EU trade negotiations talks (UK Government spokesperson James Slack dashed hopes for a comprise on fishing and level playing field issues) continue to weigh on GBP with EUR/GBP now around the 0.8950 level. With the dollar decline / risk rally pausing, GBP is yet again in a vulnerable position. Given stable or higher EUR/USD prospects, long EUR/GBP remains a better vehicle to position for GBP idiosyncratic negatives than short GBP/USD.

JPY: Suffering from the UST yield curve steepening

While the USD has been experiencing a broad-based decline, the only G10 currency which lagged the weak dollar was the Japanese yen. As per The FX road to recovery, JPY ranks as the most vulnerable G10 currency to the steepening of the UST yield curve within our FX recovery scorecard. Over time, we still look for a lower USD/JPY as the dollar's lost yield advantage (at the front end of the curve) weighs on the cross. But for now UST yield curve steepening dominates.

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