

FX Daily: Firefighting continues

Even though the crisis ultimately requires a scientific solution, investors still expect more from policy makers



Source: iStock

📈 USD: Will the Senate pass a US\$2trn fiscal stimulus package today?

Global equity markets open the week under heavy pressure as investors adjust expectations for the extent of the economic fallout. The current range of expectations suggests a second quarter US contraction somewhere on the order of 10-30% quarter-on-quarter annualised. Even though the crisis ultimately requires a scientific solution, investors still expect more from policy makers. In the US, the focus is on Congress and the Federal Reserve. On the former, the Senate failed to pass a US\$2 trillion stimulus package yesterday and is provisionally due to vote on it again at 0945ET today. Passage would be welcome. A failure to pass will add further pressure. For the Fed, the fire-fighting has moved on to whether it starts buying municipal debt and corporate debt. There will need to be changes in the Dodd Frank legislation to allow the purchase of corporate debt – but don't rule anything out, especially since the US Treasury:BBB spread has widened from 127 basis points in mid-February to 322 basis points late last week. For the dollar, there is no getting away from the massive decline in financial asset prices, and the redemptions it has prompted have sucked liquidity out of the system. Banks and corporates are hoarding dollars. We think the Fed will ultimately find the tools to get dollars flowing again in the system and a new

round of quantitative easing seems likely – but dollars may stay tight this week. It is certainly a race to the bottom in monetary policy and as we outline in [our latest FX talking](#), risk sensitive currencies look likely to stay under pressure at least for another month.

➔ EUR: Can German fiscal stimulus help?

It looks like Germany is about to agree on a large new fiscal stimulus today – a sea change in the response from a month ago. There will also be focus on whether European policy makers can fire up the European Stability Mechanism – offering credit lines to members and offering further ECB bond-buying support should it be necessary. EUR/USD has fallen victim to dollar hoarding. We can't rule out an extension to 1.05 this week, though we argue it is down here because of market dislocation. When that dislocation is fixed, we think EUR/USD should return to 1.10+ levels.

➔ GBP: Beholden to asset prices

The broken financial environment means that GBP is not able to respond to the proactive fiscal support undertaken by UK policy makers.

⬇️ Commodity FX: RBNZ introduces QE sooner than expected

Fast-moving events mean that after cutting rates by 75 basis points just one week ago, the Reserve Bank of New Zealand has today started its NZ\$30 billion QE programme. Interestingly it noted the rise in New Zealand bond yields as a reason to go early. Expect commodity FX to stay under pressure over the next month, with the Bank of Canada the next to introduce QE. We have a one-month target at 1.50 for USD/CAD. AUD/USD & NZD/USD at 0.55 & 0.54.

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