

## FX Daily: Growing pains

Global financial markets are re-pricing to a lower growth trajectory as Covid-19 case numbers rise again and fears of new lockdowns emerge. We suspect that this correction will once again present a buying opportunity for pro-cyclical currencies, but for the short term defensive positions should be maintained.



Source: Shutterstock

### **USD: Perfect storm drives the correction**

Monday saw a widespread correction across risk assets, where global growth is being re-priced lower. This is most evident in the bullish flattening of the US Treasury curve - something one would expect towards the late stages of a business cycle - and the sharp sell-off in global equity markets. With regard to rising Covid-19 case numbers, it seems the market is increasingly concerned that unvaccinated pockets of the US could be subject to the Delta variant and, while unlikely at this stage, fresh lockdowns in the US had certainly not been part of the summer recovery story.

The sell-off in risk assets was also compounded by a 6% sell-off in crude oil prices as OPEC+ finally agreed on a supply increase and new baseline numbers from May 2022. And also continued fears about Chinese property developer Evergrande and its ability to service its debt.

For FX markets this continues to see high conviction calls on commodity FX such as CAD and NOK

unwound to the benefit of the funding currencies including the JPY, CHF and EUR. And despite last week's high US CPI figures, emerging pessimism on the global growth story is seeing the markets push back the expected Fed tightening cycle. For example, 1m USD OIS priced two years' forward has fallen 20bp to 0.60% over the last few weeks. This certainly justifies the drop in USD/JPY and USD/CHF. Indeed USD/JPY could drop to the 108.35 area should this equity correction continue further.

We do see the current adjustment in risk assets as a correction, but trying to pinpoint the extent of a correction in liquidity-fuelled, frothy equity markets is a tough call. For reference, we are currently under-going the fourth pull-back in the S&P 500 so far this year, with corrections generally being worth 4-5% and the current correction being 3.6%.

DXY is trading bid near 93.00 and any move through the March high of 93.43 would certainly set some alarm bells ringing about a further strong dollar advance this summer.

### ➔ EUR: Saved by its funding currency status

Despite some of the heavy losses witnessed by the high beta commodity currencies yesterday, EUR/USD has held relatively steady. This is likely driven by: i) the EUR being a popular choice of funding currency for this year's recovery plays and ii) the Fed tightening cycle being re-priced to a lower trajectory. Unless the equity correction really gets out of hand and there is a surge back into the liquidity of the USD, we would say that EUR/USD can find a little support in the 1.1760 area ahead of the major support area at 1.1700.

Of course, [Thursday's ECB meeting](#) is the key event risk of the week and we doubt many will want to re-build long EUR positions ahead of a meeting which could spell out a lower for longer monetary easing cycle.

### ⬇ GBP: Headwinds building

GBP is finally starting to show some under-performance and EUR/GBP may well continue to spike - even to the 0.8720 area. Driving the under-performance is the sense that the UK government will struggle to ride out the surging case numbers before resorting to fresh lockdowns. Additionally, local media reports suggest the government is looking to raise National Insurance contributions to fund social security spending - the first fiscal tightening seen post the pandemic.

Cable is sitting on some pretty big support at 1.3670, a clean break of which would initially target 1.3570 - though many would be fearful of the correction extending to the 1.31/32 area.

### ➔ CNY: Some impressive resilience

We have been quite impressed with the resilience of the Renminbi. Surprise [reserve requirement rate cuts](#), deteriorating Chinese relations with the West and concerns over state support for the property sector could all have sent USD/CNH sharply higher. The fact that the Renminbi is not weakening sharply either shows some commitment from investors to the multi-year CNY bull story or perhaps the PBOC wanting to limit any sharp corrections to position the CNY more as a global reserve currency.

We also note with interest the agreement reached yesterday between the US and Vietnam on Vietnam's FX practices. Having previously been designated a currency manipulator and threatened

with tariffs by Washington, Vietnam has agreed to allow more FX flexibility. When the dust settles on this current correction in risk assets, expect the more adventurous investors to try and position for a low USD/VND.

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