

FX Daily: Hard yards and legacy issues

The extension of US social distancing measures to 30 April is good news in terms of limiting the spread of Covid-19 but of course comes with huge economic cost. Meanwhile, South Africa's downgrade on Friday serves as a reminder that sovereign debt crises may well be a legacy of this global recession



➔ USD: Slow progress in fixing money markets

That President Trump has extended US social distancing measures to 30 April is good news in terms of limiting the spread of Covid-19, although of course it comes with huge economic cost. Policy makers continue to do what they can – both China and Singapore eased monetary policy overnight and Australia announced fresh fiscal stimulus. Yet the depth of the recession remains an unknown and asset markets are adjusting and will adjust accordingly. Here Brent is sinking towards [our team's target at \\$20/bl](#) and it would not be a surprise to see equity markets hand back more of their recent gains. S&P 500 earnings consensus sees a 30% earnings decline between 4Q19 and 1Q20 and then a gradual recovery from 2Q20 onwards to leave 4Q20 quarterly earnings stronger than 4Q19. That looks too optimistic. South Africa's downgrade on Friday also serves as a reminder that sovereign debt crises may well be a legacy of the current global recession and that many more countries will be seeking official sector support. Expect commodity/growth-sensitive currencies to stay under pressure (normally a dollar positive), although we do favour continued dollar weakness against the Japanese yen, euro and Swiss franc – assuming the Federal Reserve

does manage soon to get to grips with USD funding markets – which we think it will. Favour DXY to 98 this week with a one-month target at 95.

➔ EUR: Volatility may start to ease

After recent weeks' wild ride on the USD funding roller coaster, EUR/USD may start to settle – a little. Ultimately, we think we will move to 1.15 over coming weeks and months, but it is not clear when the flood of dollar liquidity (Fed buying \$125bn of Treasuries and mortgaged-backed securities per day) will fully impact dollar pricing. For example, we would expect gold to be trading above \$1700/\$ when this is truly the case. Focus today is on European consumer confidence and German inflation. 1.10 may now be EUR/USD support.

⬆️ GBP: The right side of the tracks

One noticeable development since the start of the crisis is the division between positive and negative sovereign bond market performance. Gilts are one of the few core Europe bond markets to have rallied (other bond markets to have rallied include US, Canada, Australia, New Zealand and Norway) suggesting some benefit from flight-to-quality. That's no guarantee of FX performance (e.g. NOK has collapsed), but it can't hurt.

⬇️ ZAR: Moody's downgrades, a lesson for many

On Friday evening, Moody's finally delivered the move many had feared by cutting South Africa's local currency ratings to junk. South African government bonds now formally lose their investment grade characteristics and become ineligible for key bond indices such as the World Government Bond Index. Estimates tend to suggest this should trigger outflows from passive bond management accounts of US\$1bn+, though we presume most have tried to find a way to pre-hedge this. Going into this crisis with a weak sovereign balance sheet, South Africa was always going to struggle. [As per our latest FX talking](#), we see a risk that USD/ZAR trades to 20 over coming weeks and months. The downgrade will also serve as a reminder to many that any hopes of fiscal consolidation are futile right now and the ratings agencies have a job to do. The move will warn that a legacy of Covid-19 will likely be sovereign debt crises.

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