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FX

FX Daily: Lockdowns versus legacy issues

New Covid-19 cases and mortality rates are slowing and the focus is switching to the speed at which lockdowns can be eased. This is good for market sentiment but we're not out of the woods yet



Source: Shutterstock

➔ USD: Investors weigh up exit from lockdowns vs. legacy of debt

There have been some encouraging signs in terms of the slowdown in new Covid-19 cases and mortality rates, especially with Italy starting to see some real improvement. The focus is therefore switching to the speed at which lockdowns can be eased, with the New Zealand dollar rallying 0.6% overnight on news that the country will ease some of its harshest restrictions next week. We are also encouraged to see that investors have started to dip their toes back into emerging market securities, where last week was the first time in nine weeks that we saw a net inflow into EM debt and equity markets (inflows into Chinese equities led the move). There is also some indication that the pressure on EM (probably Asian) currencies is abating with news that Fed custody holdings of US Treasuries and Agencies on behalf of foreign central banks had risen for the first time in seven weeks – suggesting less need of FX intervention to support local currencies. These developments suggest confidence is slowly returning to the investor space and that the impending weak activity/confidence data should be taken in the market's stride. This should prove a mild dollar negative, although legacy debt issues (we discuss Mexico below, but also this week in Europe) will need to be monitored. The data calendar is light today and we'd like to think DXY stalls in the 100.25/50 area.

↓ EUR: Waiting on the EU summit

The euro remains soft on the crosses, with the market fearful that Italian debt overhang remains unresolved. Latest reports suggest some in the ECB want to focus on the creation of a bad bank, taking some of the non-performing loans off the hands of the likes of Greece and Italy and allowing better monetary transmission. That seems unlikely at this stage. The euro could stay vulnerable into Thursday's EU summit. EUR/USD has support at 1.0770/0800, EUR/CHF at 1.05.

→ GBP: BoE speakers up today

Expect to hear more on the size of the UK recession from Bank of England speakers this morning. The soft EUR environment could see EUR/GBP drift to 0.8620/50.

↓ MXN: Forced sales after Moody's cuts Pemex to junk

Late Friday, Moody's cut the rating on Mexican oil giant, Pemex, by two notches to junk status. This follows Fitch taking Pemex to junk status earlier in the month and now raises the issue of forced sales as Pemex bonds are no longer eligible to appear in investment grade bond indices. This will raise parallels with the South African situation where state support of Eskom has helped to dragged South African sovereign ratings into junk. Mexico's sovereign rating is one and two notches above junk at Fitch and S&P, respectively. Fears of a sovereign downgrade combined with [Gustavo Rangel's view that Mexico will suffer the largest economic contraction among its Latam peers](#) will likely keep The peso as an underperformer. USD/MXN could easily glide to the 24.50/25.00 area.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

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