FX Daily: Pockets of volatility

While there has been a pick-up in volatility in asset classes such as commodities and cryptocurrencies, this volatility has not extended to the likes of FX, Rates or Equities. On paper, this looks unlikely to change this week meaning that the dollar should stay gently offered.

Source: Shutterstock

USD: Unfazed

Key areas of market interest and volatility over recent weeks have been developments in the commodity and cryptocurrency space. Both have been surging and then in some cases selling off sharply as Chinese regulators have moved to rein in speculation. Concerns over commodity price gains also briefly passed into the Chinese policy space in an article suggesting that Yuan strength be tolerated to insulate against higher commodity prices. Although it now seems the original article has been removed from the China Finance web-site and the PBOC wants to distance itself from such comments.

Despite the volatility in commodities and crypto markets, there has been little - if any - spillover to other asset classes. Volatility levels in FX, equities and rates markets remain very subdued. And so far policymaker concern over asset bubbles seem to be confined to their regular home of central bak financial stability reports. The market will, however, be on the lookout for any policymaker moves in macro-prudential areas - although these will probably be related to the housing market.

Low levels of volatility should continue to favour risk-seeking behaviour in FX markets and we think a rotation out of US asset markets looking for fresher recovery stories elsewhere in the world. A key risk to that, of course, is the Fed unexpectedly withdrawing monetary stimulus. Yet the weak dollar environment coped well with tapering talk last week and this environment looks unlikely to change this week as we discuss in our G10 FX Week Ahead.

For today, many European holidays may make for quiet markets. Assuming the Fed speakers of Brainard, Mester, Bostic and George have nothing untoward to say, we would expect DXY to drift back to recent lows at 89.65.

EUR: Holding steady

ECB President Lagarde did her best on Friday to cool speculation over ECB policy adjustments. Her comments seemed to slow the recent steepening of European yield curves and the narrowing in US:European spreads - moves which have been giving EUR/USD a little support.

It is a quiet week for European data and next up on the agenda will be tomorrow's German IFO release for May. The European May manufacturing PMIs released on Friday seemed to be coming off the boil a little - bottlenecks, chips, slowing China demand? This may mean that EUR/USD struggles to push too much higher this week.

Elsewhere we see that the issue of Polish mortgages may be back on the agenda! The Polish supreme court has today said it may rule on this 'soon'. Over recent weeks the PLN has been performing very well on the back of i) a hawkish shift on the Polish MPC and ii) a view that the Polish FX mortgage issue had been kicked into the long grass with no date set for a supreme court decision on this topic. Today's news that a decision may be coming soon could prompt a little profit-taking on recent acquired PLN long positions.

GBP: On track for the June re-opening

GBP is holding onto recent gains well. Recent reports suggest vaccines are effective on the Indian variant and that the UK economy is still on track for a full re-opening on June 21st. For today, we'll see four of the BoE address the Treasury Select Committee at 1630CET. Typically we have seen the BoE a little more upbeat on UK recovery prospects than the market, suggesting GBP should stay supported.

We see a window for GBP/USD to punch above 1.4235 resistance this week.

CNY: Where there's smoke......

We were intrigued by the detailed report written by a member of the PBOC research department on Friday recommending that Yuan strength be used to insulate against commodity price pressures. That article has since been removed from the web-site and (perhaps more senior) PBOC figures have come out to say that the PBOC will seek to keep the Renminbi 'basically stable'.

Yet the article was so detailed it has put the topic of 'Renminbi-watching' back on the agenda. We think the market will now become more sensitive to watching the daily PBOC USD/CNY fixes. Any hint of a fix lower than suggested by the models could see USD/CNH starting to break under the lows for the year at 6.40. This would add to and broaden the dollar bear trend.

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