# FX Daily: Riding the bonds-off/risk-off wave

The sell-off in US Treasuries is the major driver of FX right now and the dollar is inevitably finding support

Source: Shutterstock

## USD: Another leg higher possible as bonds may stay fragile

The sell-off in US Treasuries is the major driver of FX at the moment, with the dollar inevitably finding support, and not only vs the usual victim JPY (USD/JPY has the highest correlation in FX with US 10Y yields), as commodity currencies are actually being hit the hardest. While the bond market is doubling down on reflationary bets, other assets are failing to show signs of upbeat risk sentiment. The risk is that the rise in US yields has gathered such pace so as to start being self-defeating and cause a correction in risk assets. In FX, the combination of higher US yields and choppy equity performance is indeed the perfect recipe for a stronger US dollar. The key risk events today are the release of US retail sales for January and the FOMC minutes later in the day (1900 GMT). The bond market may remain fragile as retail sales could be on the strong side (hence feeding the reflation story) and also in the run-up to the FOMC minutes, where markets are likely factoring in some initial discussion among members about the timing of unwinding monetary stimulus. The bar for a hawkish surprise is therefore set quite high, and the release of the minutes may mitigate the selling pressure on US Treasuries, possibly starting to re-establish a setting where a more controlled increase in yields does not interfer with rising equities. Until then, the dollar should continue to find some support across the board.

## EUR: Feeling the pressure, but 1.2000 should hold

The EUR has not been a major victim of the dollar rally, partly thanks to a surprise jump in the German ZEW yesterday that mitigated the uncertainty about the eurozone outlook. The calendar is quiet today in the region, and dynamics in US yields should drive most moves in EUR/USD. Additional USD outperformance may send the pair into the lower half of the 1.20/1.21 range, but the 1.2000 psychological level (it is also the 100-day moving average) could act as a fairly solid support.

## GBP: Prepare for overvaluation overshoots

As highlighted in "G10 FX short-term valuation: Most currencies have further to run vs USD", sterling has recently moved into overvalued territory vs the euro, according to our model. Sterling has usually shown a tendency to overshoot on the undervaluation side in the past few years, largely on the back of Brexit uncertainty. With this factor out of the equation now, we could see more GBP overvaluation overshoots instead. Today, cable may suffer on further USD strength, but the EUR/GBP downside bias should remain intact.

## $-bloc: CAD may prove a bit more resilient

A soft patch for the Canadian, Australian and New Zealand dollars may continue today as global risk appetite stays subdued. Of the three, CAD may face more limited downside thanks to well-supported oil prices. The release of CPI in Canada and jobs data in Australia should have limited monetary policy - and therefore FX – implications.

### Authors

**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