FX Daily: Risk assets gain a reprieve as energy costs bite

After a very shaky start, Monday proved to be a day of reversal for risk assets as President Trump hinted that military operations could end soon. No one knows whether that will be the case, but Monday's events show that the US administration is more sensitive to energy than it seemed. However, oil needs to start flowing again for this $ reversal to extend

The dollar is off its highs. But oil needs to start flowing again before we see another big leg lower

USD: A welcome reprieve

'Turnaround Monday' saw risk assets bounce substantially from intraday lows as policymakers did what they could to address the energy shock. Oil had come off its early Asian highs on reports that the G7 could be preparing a large release from emergency stocks, but the big kicker came from President Trump's comments that the war could end soon. While a large release from emergency oil stockpiles is welcome, it would only be regarded as a sticking plaster as long as Middle East oil production is shut in. Even a 400 million barrel release would only cover 20 days of lost Middle East production and wipe out a third of emergency stocks. Hence, the bigger market reaction to the Trump press conference.

What will matter most, though, is a reopening of the Strait of Hormuz and a restart of production across the Middle East. Until investors receive headlines on that score, presumably relating to some kind of ceasefire, we doubt the dollar is going to quickly hand back all the gains made over the last two weeks.

For today, let's see whether we hear of any further US measures to address the oil shock. Washington is already talking about waiving oil sanctions, and there are apparently 2bn barrels of Russian, Iranian and Venezuelan crude at sea. And there remains some talk that the US government could suspend federal fuel duties or the US Treasury could intervene in the oil futures market. As of Sunday, US average gasoline prices had risen 50 cents to $3.50/gallon.

Macro data will again take a back seat to geopolitics and the response from policymakers. But one eye will be kept on the US jobs market after Friday's soft NFP release. Thus, any big drop in the weekly ADP employment release today could weigh on the dollar a little.

Should military cessation or ceasefire talks (China, Russia, and France are involved here) gain much traction, then the 99.70 area may prove the top of the range for DXY. It seems too early to expect a big move back under 98.00, unless there are some clear improvements on the ground.

Chris Turner

EUR: 1.1500 holds

The 1.1500 level in EUR/USD withstood some pressure yesterday, but events managed to see it hold. Our FX option traders noted that even with EUR/USD offered early yesterday, the FX option market was not buying into a big downside breakout. Here, the one-month risk reversal, the cost of an EUR put option over an EUR call option, went less bid for EUR puts.

When the dust settles on this energy shock, we will have a little more time to assess how interest rate markets have reacted. Looking at the OIS forwards market, and in particular the one-month OIS priced one year forward, we can see that something like a 50bp increase has been the average response across the G10 space. However, US rates are only up 25bp on the view that this energy shock would not have such a large impact on US inflation. While the reaction in Europe has been larger. Here, EUR ESTR has been marked 65bp higher and GBP OIS a whopping 80bp. If the legacy of this oil shock is that EUR:USD two-year swap differentials need to be priced even narrower, then support at 1.1500 in EUR/USD can prove more solid.

1.1650 is the initial resistance for EUR/USD and it is not clear that EUR/USD needs to rally much more today unless we see some material progress towards a ceasefire.

Chris Turner

GBP: BoE repricing provides a temporary lift

As above, the sterling curve has seen one of the biggest repricings relating to this oil shock. That is probably a function of UK inflation already being well above target at 3% and the Bank of England having sufficient hawks to call time on the easing cycle. Clearly, the duration of the oil shock is going to have a big bearing on this debate. As to whether gilts come under pressure from government measures to limit the energy shock to consumers, the government has some time.

Utility bills get priced over a February-May window and the government will be hoping that natural gas and electricity prices have turned lower well before energy caps are set and consumers receive their utility bills in July.

We are not big fans of sterling, but given that both the eurozone and the UK are hit by the energy shock and that BoE monetary response could be greater, there is outside risk this EUR/GBP correction extends back to the 0.8600/8615 area again – which should prove strong support.

Chris Turner

AUD: Proving resilient

AUD/USD is outperforming again and has delivered a very resilient performance as a high-beta currency. The reason it has held up is probably because we have yet to see a major equity sell-off, even though there was a hint of that a week ago. And the positives also come from Australia's position as an energy exporter (terms of trade up sharply) and a proven hawkish Reserve Bank of Australia.

AUD/USD also saw some positive news overnight from the Chinese February trade data, where imports surprised on the upside. Let's see whether AUD/USD can push through the highs of the year at 0.7150.

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