FX Daily: Stick with pro-cyclical, dollar negative story

The US jobs report has given the reflation trade a shot in the arm, boosting stocks, commodities and pro-cyclical currencies, and steepening yield curves around the world

Source: Shutterstock

USD: FOMC should not derail $ bearish reflation trade

Friday's remarkably positive US jobs report has given the reflation trade a shot in the arm and supported cyclical stories around the world. This environment is characterised by firmer equities (cyclicals such as financial services outperforming), firmer commodities, steeper yield curves (witnessed around the world) and the outperformance of pro-cyclical currencies (commodities and emerging markets) against the dollar. Two of the key threats to this prevailing narrative are: i) a second wave of Covid-19 and ii) the Federal Reserve taking away the punchbowl of cheap liquidity. The latter is particularly in focus with Wednesday's FOMC meeting, although we think it is far too early for the Fed to be undermining risk or dusting off any descriptions such as 'irrational exuberance' for equity markets. There may indeed be some focus on yield curve control (YCC) at the short end of the yield curve, but we are not looking for the Fed to dent the risk rally. Instead then we look for this benign investment environment to continue, which could see investors return funds to emerging markets and the dollar stay under pressure. We tentatively think this environment may last a couple of months – as was the case during the normalisation of investment trends in 2009. It is a quiet day for US data, but overall DXY looks headed to 96.00.

EUR: Europe surprises as a pro-cyclical story

June has started off as a very positive one for equity markets, with Europe surprisingly leading the advance (Eurostoxx +11% MTD). Aggressive action from European policy makers has clearly helped here. On that subject we will today here from European Central Bank President Christine Lagarde in late afternoon and tomorrow we'll hear more from EU Finance Ministers as they debate the implementation of the EU recovery plan. EUR/USD may be due some consolidation after a very strong rally, but we suspect the 1.1230/40 area offers good support now before EUR/USD advances to the 1.15/16 area. EUR/CHF has been positively re-assessed over the last two weeks and can trade up to 1.10 if our EUR/USD scenario comes to pass.

GBP: UK may be overlooked as a re-rating story

Despite the trend for re-rating stories – and investors very underweight UK equities – we are not looking for a UK re-rating story anytime soon. Our team's analysis of Google Mobility data suggests the UK is at the back of the pack for a return to normal economic activity and there's very little clarity on Brexit negotiations. We'd stick with a 0.91 EUR/GBP target for end June.

AUD: Speculators surprisingly still short

AUS/USD remains strong and surprisingly there have been no signs of speculators cutting shorts. AUD/USD breaking 0.7030 could be a surprise package. The surge in iron ore on Brazilian supply issues is also AUD supportive.

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