

FX Daily: Sweet spot for cyclical commodity FX

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⬇️ USD: Sweet spot for cyclical commodity FX

The reflation theme dynamics are fully manifesting themselves in the G10 FX market. With equities and commodity prices going higher and the US Treasury curve steepening, it is the cyclical commodity FX that leads the gains, while only the Japanese yen, with its negative correlation to UST yields, is losing ground vs the dollar. The outlook for: (1) the strong 2Q rebound in the global economy; and (2) a cautious Federal Reserve remains too appealing to change the current trend. The strength of the reflation theme is also very evident in the rouble, which continues to shrug off the foreign policy risk and is now close to the 73.00 level. With the Central Bank of Russia turning modestly hawkish last week (in turn providing a cushion to RUB's real rate), the currency's positive exposure to commodity prices and the supportive seasonality in the first half, we expect USD/RUB to head to the 72.00 level.



EUR: Staying supported

The focus today is on the February German ZEW survey and 4Q20 eurozone GDP. The latter is widely expected to contract by 5.1% year-on-year while the former should see a modest dip. Given the general market sentiment, this is unlikely to affect EUR much and EUR/USD should stay above the 1.2100 level today.

GBP: Pushing ahead

Sterling continues to push ahead as the dividend of rapid vaccination and the currency's relative high beta among the three majors (USD, EUR and JPY) both help in the current reflationary environment. We expect the EUR/GBP medium term valuation gap to continue closing (we estimate EUR/GBP medium-term fair value at 0.82, based on our BEER model) this year and next. But with the GBP showing signs of a modest overvaluation based on our short-term financial fair value model, the pace of near-term appreciation may slow from here.

HUF: High growth and high inflation

The focus is on Hungarian GDP today, with risks clearly tilted to the upside, especially due to government spending, as it is hard to measure whether the spending spree in December impacted GDP or not. In the upside risk scenario, we might see a 0.0-0.1% quarter-on-quarter growth rate in 4Q20. The solid growth outlook, coupled with the clear inflation pressures (we expect April/May CPI to be around 4%, with clear upside risks), has already been translating into market pricing in rate hikes (around 40bp by the year end). But unless the forint embarks on a more pronounced depreciation trend, we see a high bar for the National Bank of Hungary to hike interest rates, in effect eventually taking some support from HUF. We don't expect EUR/HUF to dip below the 355 level, and underscore our forecast of EUR/HUF 363 by the end of 2Q. HUF remains our least preferred CEE currency.

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