

FX: Temporary and natural correction

While risk assets will likely remain under pressure today and in coming days, we don't see this sell-off as the start of a long-lasting trend



Source: Shutterstock

USD: Textbook-like reaction in the FX markets

What started as a bond market sell-off has now fully spilt over into risk sentiment, with equity markets across the board recording material losses (S&P 500 recorded the biggest one-day loss since 2011). It is the G10 low yielders that outperform in the current regime while G10 commodity currencies suffer (both via the general risk channel and falling commodity prices). While one could argue that the correction in equity markets was long overdue, in our view the playing field has not changed dramatically to the extent that it warrants a long-lasting and persistent risk asset sell-off (vs a temporary and natural correction). Among other things, the global economy shows signs of synchronised growth, non-negligible tightening is already priced in for the Fed, a material correction in the bond market already happened while private sector liquidity is expected to remain abundant (as per the projected rise in global assets under management, which should lend support to equity markets.) While risk assets will likely remain under pressure today and in coming days, we don't see this a start of a long-lasting trade. USD to benefit for now.

EUR: Very high bar to talk the euro down

As per the current equity market sell-off, the modest EUR/USD decline is in line with recent EUR

dynamics whereby the currency's sensitivity to risk assets has risen materially in recent months ([see the link](#)). Hence the current, yet modest EUR downside. The current EUR/USD decline is more about risk sentiment rather than Mario Draghi's comments yesterday about "volatility in the exchange rate," which in our view will have a limited impact on EUR (partly because this year's EUR/USD upside was primarily driven by the broad-based USD weakness).

JPY: In a sweet-spot

The Japanese yen remains in a sweet-spot. With the bond market sell-off fully spilling into the equity markets, the safe-haven yen benefits (particularly when yield differentials are no longer moving against JPY). USD/JPY 108.28 is the next support level to watch.

CZK: Pushing for new highs day by day

EUR/CZK has hit new post FX floor lows of 25.14, with the latest central bank EUR/CZK forecast providing new impetus for more Czech koruna strength. As for today, the December retail sales should be solid while industrial output should surprise on the upside, in turn supporting CZK. However, we note that (a) the more and faster the EUR/CZK declines, the less will the CNB eventually need to hike this year; (b) hikes will be necessary should the koruna not appreciate as much as the CNB expects. Still, lower EUR/CZK looks to be the end game.