FX Daily: The calm after the storm

As geopolitical risk subsides- at least for now- the market focus is shifting to Federal Reserve speakers

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USD: Focus shifting from Iran to Fedspeak

Yesterday's statement by President Trump seems to have endorsed the markets' prevailing view that the US-Iran spat is heading towards a de-escalation. The repricing of geopolitical risk is mostly weighing on the yen, which has faced an asymmetrical downward correction, with USD/JPY now above the levels it was trading before the US drone strike on 3 January. At the same time, positive-beta currencies are failing to fully cash in on this optimism, largely because: (a) oil has given up recent gains (WTI is trading below $60/bbl) as fears around supply disruptions eased along with geopolitical risk, and (b) the dollar has remained on a recovery path, offsetting most gains. If comments by both Iranian and US officials continue to suggest that tensions are abating today, markets may start to move back to focusing on fundamentals: no key data releases are due today, but a slew of Federal Reserve speakers will be watched. Richard Clarida speaks at 1300 GMT and is followed in the afternoon by Neel Kashkari, John Williams, Tom Barkin, Charles Evans and James Bullard. Markets are currently pricing only 20 basis points of easing in the next year and attaching a mere 2% probability of a cut in the first quarter. For now, a less upbeat tone on the rate path by Fed members appears to be the only catalyst to dam up the dollar momentum.

EUR: Implied volatility keeps dropping

EUR/USD has been trading at the bottom of its recent range, broadly untouched by the US-Iran tensions. In the option market, 3-m implied volatility on the pair dropped for a third consecutive day and it is now at its lowest level in a month. Today, labour data out of the eurozone is unlikely to move the market. We will likely need some material surprise in tomorrow's US payrolls to stir EUR/USD, that is otherwise likely to remain stubbornly rangebound.

GBP: Market unimpressed by Jonson-Von der Leyen meeting

Yesterday's cordial meeting between the EU's Ursula Von der Leyen and Prime Minister Boris Johnson did not have major implications for sterling despite a fairly constructive tone, as markets seem to acknowledge that the path for negotiations will likely prove bumpy. On top of that, Johnson has reiterated his reluctance to extend the transition period, which remains a key factor of uncertainty for markets. For now, GBP is likely to keep trading in a relatively tight range.

KRW: Leading EM rebound

As markets price out the risk of a full-on US-Iran conflict, the emerging markets space has moved into positive territory. In this context, the Korean won is coming up as the key outperformer. Such momentum may extend in the next few months. Indications that the semiconductor cycle has bottomed out seem to be preparing the ground for a recovery in KRW in 2020 (as long as global risk sentiment stabilises). We see USD/KRW dropping to 1120 by year-end.

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