FX Daily: The delta divide

As traded FX volatility continues to edge lower, the market will increasingly back those currencies where central banks are confident enough to tighten policy. How a country is faring with the Delta variant will have a big say in that policy decision. Australia's RBA is the latest central bank to effectively report a lost quarter and an extension of QE.

USD: Dollar stays on the back foot in quiet markets

As FX liquidity levels improve after Monday's US Labor Day holiday, it is time to re-assess some core themes. The first is that a dovish Fed still dominates global asset markets, allowing most equity markets to continue their gentle rallies. The second, and a central one to FX, is the outlook for domestic monetary conditions of which FX plays an important role. Today we have seen the RBA, after a lost quarter of growth on the Delta variant and lockdowns, effectively extend by three months their pre-announced pace of QE. Rob Carnell discusses today's monetary decision in more detail here.

Clearly, the RBA would not welcome a stronger currency right now, while other central banks readying to or already tightening would welcome currency strength. Into that category, we would put the NOK in the G10 space and many in the CEE region (ex Poland) with vaccination rates relatively high in Europe. The Latam is more mixed and low vaccination rates in Asia and aggressive lockdown practices are generally keeping the Asian FX region as an under-performer. We see this environment continuing and today publish our latest set of views in the September edition of FX talkING.

For today, the US data calendar remains light and we can see some more range trading before the pace of central bank meetings picks up later this week - with the highlight being Thursday's ECB meeting. Expect DXY to drift towards the lower end of a near-term range at 91.80/92.00.

EUR: Waiting on the ECB

European equities continue to perform quite well and despite fears about a Chinese slow-down and what it would mean for the European manufacturing sector, Chinese trade data for August surprisingly painted an encouraging picture. Both exports and imports far surpassed expectations. Equally today's release of German industrial production for July showed signs of life.

EUR/USD has understandably been trading a quiet range in a holiday-thinned week, but should stay supported into Thursday's ECB meeting where the pandemic PEPP asset purchase scheme is scheduled for review. We doubt today's German ZEW is a market-mover and again would not be surprised were EUR/USD to continue trading a 1.1850-1.1910 short term range.

GBP: A truce in the sausage wars?

Recently we had been warning about UK-EU tension at end-September when deadlines expired on exclusions to the N.Ireland protocol. Yesterday we received some surprisingly good news from UK officials that these exclusions would be extended further, thus preventing new customs checks on chilled meat etc. Details on any agreement were sparse, but it does suggest that UK-EU negotiations are on-going and presumably fruitful if the EU are prepared to extend them.

On another core topic, it does look like PM Johnson will go ahead with announcing a National Insurance tax rise later today to fund social care. This slight brake on consumption will probably cement the views that the BoE terminal rate will struggle to make it above the 0.50% area - meaning that GBP receives no further support from the BoE story.

GBP looks beholden to the neutral dollar story and the short-term bullish EUR story as we await the outcome of Thursday's ECB meeting.

ZAR: On thin ice

The ZAR continues to power ahead, but as we discuss in this month's FX talkING, we think USD/ZAR will struggle to make it below the 14.00 level on a sustained basis. Yes, the commodity story is still playing out for the ZAR, but growth is weak and the ZAR does not enjoy the real rate protection afforded some other EM high yielders.

As a very high beta currency on global growth and also the Renminbi, the ZAR would be in the front line to be hit were USD/CNY to break above 6.50 as Iris Pang expects. We think the 14.00/25 area would be a good region to increase ZAR hedge ratios against any difficulties emerging this autumn.

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