FX Daily: The funding currency of choice

Despite the risk rally yesterday, EUR/USD dipped lower and once again broke the 1.1000 level. We think the euro will continue to be used as the funding currency of choice, translating into further downside risk to the pair

USD: Further signs of stabilisation in oversold commodity currencies

Cyclical currencies and commodity FX continue to rebound. First, the Chinese government's decision to halve tariffs on some of the $75 billion worth of US imports is helping to reduce concerns about weaker growth in China and around the world. Second, the extension of the OPEC+ talks keeps alive the prospect of additional production cuts. The tariff cut, along with central bank easing earlier in the week, is generally risk positive while the OPEC+ news should provide an additional anchor to the previously battered oil-exposed currencies (be it the Norwegian krone in the G10 FX space or Russian rouble in the emerging markets space). With USD/CNY now back below the psychological 7.00 level, pressure on EM FX and cyclical G10 currencies should be easing.

EUR: The funding currency of choice

Despite the risk rally yesterday, EUR/USD dipped lower and once again broke the 1.1000 level. This suggests the euro is being used as funding currency of choice for undervalued G10 and EM FX.

Given the meaningful interest rate differential vs the US dollar (you can pick up in excess of 2% carry per annum if the euro is used as a funding currency rather than the dollar) and the lack of clear catalysts for a stronger euro (uninspiring growth and inflation outlook, which makes monetary policy normalisation from the European Central Bank a low probability event – today's weak December German factory orders provide a case in point), we expect the euro to continue to be used as the funding currency of choice, translating into ongoing downside risks to EUR/USD.

GBP: Not benefiting much from improving global sentiment

While sterling benefited from the risk rally in the middle of week, its gains vs the EUR and USD have been limited, as the overhang of upcoming UK-EU negotiations limits GBP upside potential. We continue to think GBP rebounds will be shallow and short-lived. Based on our financial fair value model, EUR/GBP does not exert meaningful signs of short-term misvaluation, allowing for eventual upside to the cross.

CZK: On hold today but risks of a hike in 2Q20 remain high

We expect the Czech National Bank to remain on hold today as external uncertainties (mainly the coronavirus effect) are likely to keep the board cautious (see CNB Preview for more details). Still, one prudent rate hike in May remains on the table (a) should the downside risks to the global economy fade; and (b) CPI inflation, which is already above the upper tolerance band, moves towards 3.5% year-on-year in coming months. The new CNB staff forecast should continue to show the need to increase interest rates in coming months. With EM FX rebounding and uncertainty over whether the CNB will hike or stay on hold, the bias is for lower EUR/CZK today.