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FX Daily: Third wave woes hit the euro

EUR/USD has broken below the important 200-day moving average support level of 1.1863, as European countries tighten or extend lockdowns in response to rising Covid cases

Source: Shutterstock

USD: Benefiting from problems elsewhere

Concerns about the third wave in Europe and associated new lockdown measures continue to weigh on sentiment and benefit the dollar. Unlike during the USD appreciation in February, this time the struggling oil price is not protecting oil exporter FX (Norway's krone and the Canadian dollar in the G10 space). Factors behind USD strength have moved away from concerns about the reflationary impact on US Treasuries to concerns about global growth expectations. Concerns about eventual corporate tax hikes in the US are also not helping risk sentiment. USD to stay bid today, with the heavily European FX weighted DXY to continue grinding higher towards the 200-day moving average of 92.65.

EUR: Breaking important technical levels

With the extension of European lockdowns delaying any eurozone economic recovery, EUR/USD has broken below the important 200-day moving average support level of 1.1863. Technically, this keeps EUR/USD vulnerable. We also note that while EUR/USD is currently trading below its short-term fair value, the mis-valuation is less pronounced (hence offering a lower degree of protection) than in the past two weeks given that the EUR/USD short term fair value deterioration –the current mis-valuation is c.1.5% vs an average 2% undervaluation observed over most of the past two weeks. The eurozone PMI should have limited impact on the euro today as lockdown concerns dominate.

GBP: Looking through the dip in CPI

UK February CPI surprised on the downside this morning, at 0.4% year-on-year vs the 0.8% expected (largely due to discounting for clothing). But with the full focus being on the UK vaccination advantage vs the EU and still more pronounced pick up in UK CPI expected in months to come, the effect on market pricing on the Bank of England's rate path, and hence the potential downside to GBP, should be muted.

CZK: No frontloaded tightening from the CNB, but hikes in 4Q likely

The Czech National Bank is set to stay on hold today and should reiterate the latest CNB board members' comments that frontloaded tightening (ie, in 2Q) is unlikely given the deteriorating Covid situation. Still, with inflation higher than the CNB expected and 4Q20 GDP stronger, the case for tightening in 2021 is intact. We look for two hikes in 4Q (see CNB Preview). The Czech koruna is our top pick in the central and eastern European region and we expect it to reach the EUR/CZK 25.50 level in 2H21. As observed yesterday, positioning remains the key risk to CZK (as it exaggerates the periods of CZK weakness), but with EUR/CZK back to 26.20, it screens around 1% overvalued based on our short-term financial fair value model. Should CZK fail to recover in 2Q, the case for even more aggressive CNB tightening will build and, in turn, strengthen CZK.

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