

FX Daily: Unsustainable rebound in sterling

Another round of UK-EU trade talks starts today and there's little reason to expect any real progress. The fading prospect of a Brexit extension should weigh on sterling in the coming days and weeks



➔ USD: Taking the glass half-full approach

Markets have shrugged off concerns about US China trade tensions for now, yet again taking the glass half-full approach. The rally in pro-cyclical high beta currencies yesterday has not reversed and, despite the social unrest in the US and President Trump's threat to deploy the military, both European and US equities futures point to higher levels. With oil prices remaining underpinned (one of the key factors determining the direction of risk assets in recent weeks), the risk environment is likely to remain constructive today and the broader USD index should trade on the weak side. In Australia, the central bank kept the interest rate and yield target unchanged overnight. Despite the recent AUD gains (the second strongest G10 currency after the Norwegian krone over the past month), the board did not lean against currency strength, in turn modestly benefiting AUD and making it one of the outperformers in the G10 space overnight.



EUR: Directionalless day

It is a very quiet day on the eurozone data front, with EUR/USD price action to be determined by wider risk sentiment today. The extension of the constructive risk environment suggest a flattish EUR/USD today, with the main driver of the cross for this week being the European Central Bank meeting on Thursday.

↓ GBP: Unsustainable rebound

Another round of UK-EU trade talks starts today. As we discussed in [Brexit returns as major headache for the pound](#), there's little to suggest we should expect any real progress. The fading prospects of an extension to the post-Brexit transition period, and the risk of supply chain disruption at the start of 2021 (either without a trade deal or with a soft, narrowed deal), are to weigh on sterling in coming days and weeks. Although GBP rallied yesterday in line with the recovery in general risk appetite, the forthcoming UK-EU trade negotiations overhang should dominate and weaken GBP this month. We target EUR/GBP 0.91 by end June, with periods of GBP strength being unsustainable. Note that following the GBP rebound yesterday, only around 2% worth of risk premia is currently priced into GBP vs EUR based on our model. This is well below the 5% risk premium seen last August, suggesting further room for GBP decline.

→ CE3: Pushing higher

CE3 FX continues pushing higher vs EUR, further paring some of their Covid-19 crisis related losses. With EUR/USD gridding higher, low risk CEE FX continues to offer good risk adjusted characteristics vs USD. [As was the case in Poland and the Czech Republic, Hungary's May PMIs](#) should show some modest recovery from ultra-stress levels today. In the relative CEE FX space, we see the Czech koruna as the most attractive currency (due to monetary policy, which is not overly loose, no need for FX floor and solid fiscal position) and we prefer it to Hungary's forint and Poland's zloty.

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