FX Daily: 'V' shape suffers adverse reaction

Investor confidence in a V-shaped recovery is starting to falter and risk assets look vulnerable over coming days

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USD: V-shape sentiment gets stress tested

Financial markets remain at risk of a further correction as conviction over reflationary trades (long equities, long commodities, short dollar) gets stress tested. News of a pause in one of the leading vaccine contenders has not helped sentiment this week, although the path to a vaccine solution was never going to be a smooth one. From a macro perspective, the 'V'-shape consensus also is being tested by the drop in oil this week. Here, doubts are emerging about the strength of the rebound in Asian demand, although an OPEC+ response (more cuts) could emerge to support prices over the next week. With US Congress still struggling to find common ground on a fourth stimulus package, we would say risk assets remain vulnerable over coming days – even though the Federal Reserve has plenty of room to expand quantitative easing further should it be necessary. We're bearish on the dollar into year-end but acknowledge the DXY correction could extend up to the 93.85/94.00 area before more sellers emerge. The highlight of a quiet data calendar today will be the Bank of Canada rate meeting. Canada has not been performing that badly this year (13.5% peak to trough drop), but like many other central banks look out for a dovish spin and a call for more fiscal support. We'd look for this USD/CAD correction to stall at 1.3270/3350.

EUR: Consolidating into the ECB

EUR/USD has actually been holding up quite well to this week's correction in equity markets. It suggests the short dollar position is held with some conviction. In our FX week ahead, we had felt that 1.1750 (approached in Asia last night) would be the low point for the week – although that now looks like it will be tested throughout today. Certainly, the approach of tomorrow's European Central Bank meeting is playing a role here too and we can't rule out an extension today to 1.1700. We'll also see Hungarian inflation early today. Any upside surprise in inflation (expected at 3.9% year-on-year) would add to the negative yield story and risk depressing the Hungarian forint even further.

GBP: Legislative landmines

All eyes today are on the release of new UK legislation regarding the internal market and whether it seeks to re-write the Northern Irish protocol agreed with the EU last year. The resignation of the government's head of legal yesterday suggests the changes will be material and that sterling will stay vulnerable. 1.2870 looks a possible support level for cable today, however.

ZAR: Growth matters

After a very good run in August, the South African rand has started to lose some of its shine. The 51% quarter-on-quarter decline in 2Q20 activity announced yesterday served as a reminder that South Africa will struggle to reverse rising debt-to-GDP trends. We could see 17.30/50 in USD/ZAR if equities weaken further.

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com