FX Daily: Virus outbreak in Italy points south for the euro

Renewed fears about the spread of the coronavirus outside of China should support demand for safe havens

Source: istock

USD: Back on the rise

The dollar faced a setback after an extended rally on Friday as the first grim piece of data (Markit PMIs) in a long time slightly dented investors' optimistic stance on the US economy. This week starts with a re-appreciation of the dollar mostly on the back of renewed fears about the spread of the coronavirus outside of China, as Korea and Italy reported a surge in the number of cases, and the G-20 raised concerns about global growth. This may prove to be the trigger for another round of safe-haven demand and, while averting another slump in the Japanese yen, it may well put additional pressure on pro-cyclical currencies and ultimately prove supportive for the dollar. As we highlighted in our FX Week Ahead, we suspect the lack of good alternatives to the US dollar within the G10 space (both as a safe-haven and in terms of yield advantage) still points to a supported USD this week. We expect DXY above 100 within the next few days.

EUR: A bad combination of virus fears and data

Over the weekend, Italy saw the number of coronavirus cases rising to above 140 (the most outside of Asia) and the government took extraordinary measures (quarantined 50,000 people and cancelled public events) to curb the outbreak. The latest Italian growth numbers were already a drag on the eurozone's growth, and the health emergency suggests more downside ahead. In general, this raises concern that the impact on the consumer sector in Europe may have been underestimated. Combined with already strong concerns about the disruption to supply chains, markets may well be pushed to have an even more pessimistic stance on the eurozone outlook. EUR/USD back below 1.08 today.

GBP: Political drivers unlikely to help

A quiet week in terms of data releases is going to leave space for the other two key drivers of sterling: UK-EU trade negotiations and hints about the content of the forthcoming UK budget. We suspect these will not support the pound, as negotiations may enter an even more confrontational phase and the government is unlikely to endorse the market's high fiscal hopes.

JPY: Global pandemic fears to limit losses

Last week, we highlighted how the market concerns around the coronavirus were shifting towards the longer-term economic impact, as the risk of a global pandemic seemed to be abating. This likely contributed to slump in the JPY. The revived fears about the spread of the Covid-19 outside of China puts the market focus back on the short-term and should avert another USD/JPY rally for now.

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com