

## FX markets leave lockdown behind them

This month, we've been tasked with looking at the effects of lockdown exits on FX markets. The truth is that there does not seem to be a strong relationship. Instead, FX markets are being driven by the abundant liquidity story. As summer progresses, however, we expect US elections to make their mark. Both themes are dollar negative, in our opinion



Source: Shutterstock

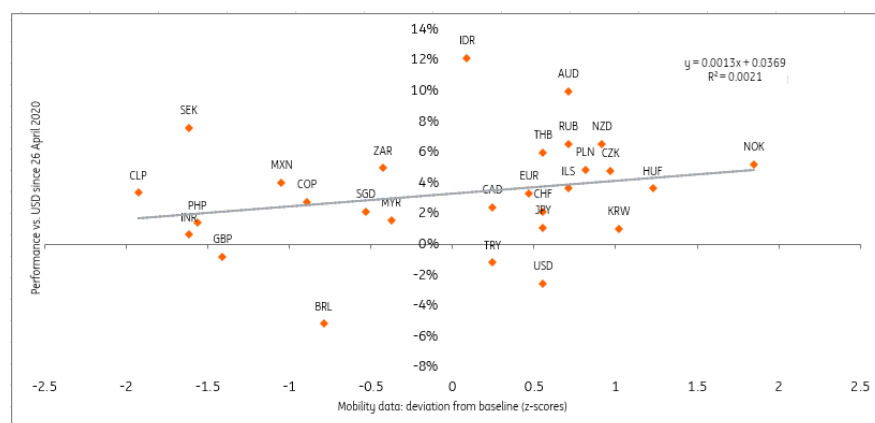
### Leaving lockdown

It has been nearly two months since some of the lockdown exit measures were announced in continental Europe and Google mobility data shows the gentle upturn in European activity from early May.

Below we look at a snapshot of FX performance against Google mobility data since 26 April (when the end of lockdowns was announced in both Italy and Spain). Has a greater degree of recovery in that mobility data-driven FX performance? The short answer is no.

At a stretch, one could argue that sterling and Norway's krone do reside in sensible places on the scatter chart – although Downing Street's intransigent position on Europe and the recovery in oil might also have a say here. For the rest, there does not seem much of a relationship and for the US dollar (we look at the Bloomberg BBDXY index here), we argue that abundant liquidity has been a bigger driver of performance.

## FX performance versus change in Google mobility data since late April



Source: ING, Google

## Risk On, Dollar Off... for now

In terms of broad drivers of the FX market, we still believe the Federal Reserve's printing presses have set the overall FX tone.

Recall that back in September the Fed discovered the point at which low excess reserves held at the Fed would trigger some tightening of financial conditions – especially in USD repo markets. That level was US\$1.25 trillion. Excess reserves now held at the Fed are over US\$3 trillion and the many Fed measures to restore confidence in the financial system since March have breathed air into the lungs of global risk markets. After nearly 14 weeks of outflows from late February, emerging markets have now enjoyed five consecutive weeks of portfolio inflows.

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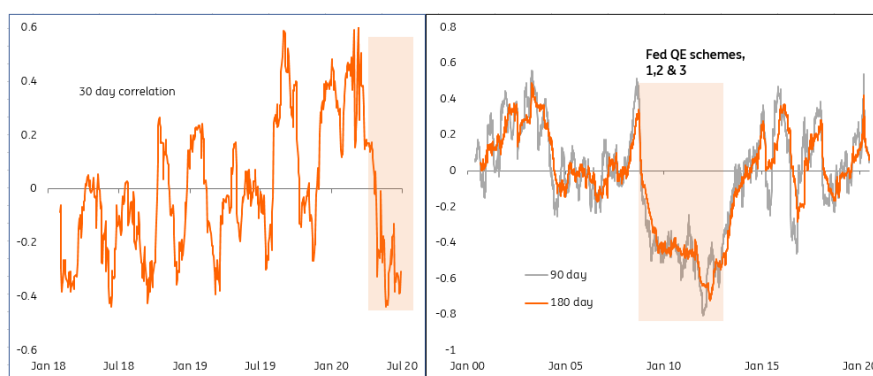
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Fed money printing has now secured what seems to be a stable negative correlation between risk assets (we look at the US S&P 500 index) and the dollar (DXY). We show how the correlation has shifted over the last couple of months. This recent turn is consistent with the relationship seen in

the 2009-2012 period when the Fed was forced to initiate quantitative easing programmes one, two, and three. Tapering of the Fed's balance sheet was only discussed in June 2013 and implemented in December 2013, when the correlation really started to reverse.

As long as the Fed is still buying assets and prepared to do more, we expect this negative correlation, Risk On, Dollar Off, to dominate financial markets over the coming quarters. Economies slowly getting back on their feet should mean a backdrop of a benign dollar bear trend in the second half of the year.

## DXY versus S&P 500 correlations, now (2020) and then (2009-2012)



Source: ING, Bloomberg

## The elephant .. or is it donkey? in the room

Probably the biggest threat to the above FX regime is US elections.

Typically, we would expect these to start moving markets from late August/early September onwards. We do not think Joe Biden's lead in the polls has played a role in FX pricing just yet – but this will undoubtedly be a theme for 3Q20.

Below we take a look at how the DXY has performed in presidential election years when the White House has changed hands. We would discount the strong dollar gains in both 1992 and 2008 when the Exchange Rate Mechanism crisis in Europe and the global financial crisis were dominant themes. But it seems fair to say that the dollar did not embark on a big rally ahead of the early November result.

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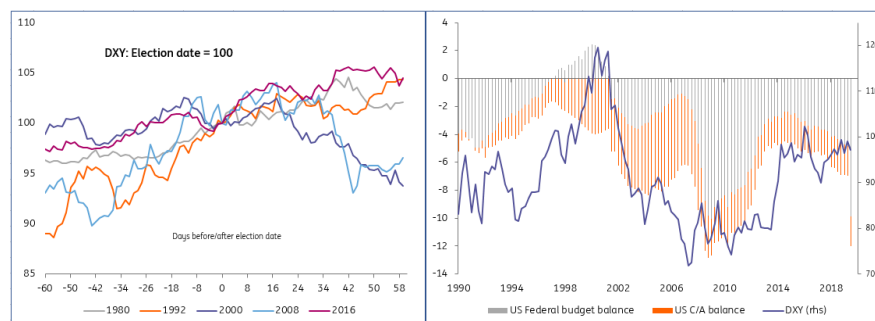
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[At the same time, the press is starting to further explore the idea of a dollar crash.](#) At the heart of that story is the sharply widening twin deficit (driven by the fiscal side). And mapped against the dollar it certainly makes an impressive chart.

While wider deficits alone do not make a story for a weaker dollar – after all, which government can boast of a narrower fiscal deficit now – they do make the point that the US is increasingly relying on the kindness of strangers to fund its balance of payments. And if uncertainty arises as to what the US growth package constitutes – an uncertain election outcome will not help here – the dollar should become more vulnerable as 3Q progresses.

For this reason, we are still comfortable with EUR/USD rising to 1.18 by end 3Q20 and finishing the year at 1.20. DXY should fall around 6-7% during this period.

## DXY in election year, DXY versus US twin deficits



Source: ING, Bloomberg

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