FX: Race to the bottom

A big drop in oil, troubles in tech and a damning report on China mean the FX flight-to-safety will likely continue today

Source: Shutterstock

USD: Pick a theme, any theme

FX markets remain buffeted by a variety of cross-currents, amongst which the fall in US tech stocks was trumped by an 8% fall in crude oil yesterday. That crude move had all the hallmarks of a market caught short downside strikes in the options market, where 3m Brent implied options volatility surged to 44% having traded near 25% for most of the year. The crude sell-off seems a little overdone and could reverse if the EIA weekly crude inventory data (released today at 1630CET) does not show a ninth week of rising inventories. In fact, the API inventory data yesterday showed a surprise fall.

Elsewhere US tech stocks closed in fragile territory and we suspect the correction has more to go, which could trigger a little more re-pricing of the Fed curve and weigh on the dollar. But it seems too early to be looking for bullish alternatives to the US. Emerging markets may well stay on the back foot as pressure stays on China. In an updated report reviewing China's activities since being subjected to $250 billion of US tariffs, the US Trade Representative yesterday concluded, "China fundamentally has not altered its acts, policies, and practices related to technology transfer, intellectual property, and innovation, and indeed appears to have taken further unreasonable actions in recent months". Expect defensive positioning to dominate, favouring the Japanese yen, Swiss franc and perhaps the high-yielding dollar. Although we are probably now getting into territory where incentives are increasing for Washington to talk the dollar lower. Favour long JPY positions on the crosses and prefer DXY heading back to 95.70/96.00 on some softer US data today.

EUR: European Commission to start the EDP process today

In a widely expected move, the European Commission should today release a critical opinion on the Italian budget, which should fire the starting pistol on the Excessive Deficit Procedure. This procedure will take several months, but stands to keep Italian bonds and the Italian banking sector under pressure. Favour the euro underperformance in Europe and probably further choppy EUR/USD trading in a 1.1350-1.1450 range. EUR/NOK should come lower as well, if oil stabilises.

GBP: PM May heads to Brussels, more noise expected

Speculation that Prime Minister Theresa May can renegotiate her withdrawal agreement with Brussels looks misplaced and instead her trip today is all about writing the non-binding political declaration that will accompany the exit. This looks a tricky process as well. Slightly favour EUR/GBP lower on EUR travails, but a very uncertain picture.

RUB: Crude stabilisation can see rouble extend gains

The rouble withstood yesterday's crude sell-off amazingly well. 3m implied RUB yields of 7% could see the RUB favoured as an uncorrelated story. USD/RUB to 65.

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