

FX Daily: All hands to the pump

After the Fed rate cut over the weekend, we expect a cascade of lower policy rates from other central banks this week. But monetary policy can only go so far and the focus today will switch to what governments are willing to do to combat the economic fallout from the coronavirus



📌 USD: Fed emergency cut and QE will weaken the dollar...one day

Central banks around the world have rushed to ease policy. The Fed yesterday did about [as much as it could possibly do](#), by cutting rates to zero and re-starting a large quantitative easing programme. We've also seen a large cut from the Reserve Bank of New Zealand and preparedness from both the RBNZ and its Australian counterpart to start printing money with large scale asset purchases. We should expect a cascade of lower policy rates this week (starting with the Bank of Korea later today probably). Lower policy rates alone can clearly only do so much to restore confidence. The focus today therefore switches to governments. Given the scale of the expected contraction in the second quarter – our team sees the US contracting 8% quarter-on-quarter annualised, as bad as the fourth quarter of 2008 – the onus is for some large-scale fiscal response. China is impressing here with a fiscal package this year [worth 6%+ of GDP](#). G7 leaders

hold a video conference call at 15CET, where a Communique should be released shortly thereafter. However, looking at the US, the only Covid-19 bill passed in the House early Saturday looks very piecemeal and perhaps even rejected by the Senate. The prospects of a 5% of GDP US fiscal stimulus look remote right now – and stands to keep US equity markets under pressure throughout March. For the dollar, we think the new QE scheme will ultimately bring the currency lower. The exceptionalism of US growth and rates is gone and QE is a policy to weaken the dollar. The timing of the dollar sell-off remains uncertain given the opaque nature of the financial plumbing system – e.g. there has been some suggestion last week's dollar rally also owed to large dollar cash calls on Letters of Credit. Our position here is therefore that any dollar strength against the likes of euro and yen proves temporary (perhaps the limits have been reached at 1.10 and 108, respectively) and once confidence returns to money markets (e.g. the EUR cross currency basis swap narrows in again) the dollar can sell-off. Events are starting to favour the second path in [our EUR/USD scenario analysis](#).

➔ EUR: In need of stimulus

It will be interesting to see what the Europeans have got to offer in terms of fiscal stimulus – the Eurogroup meets today. The European Central Bank's move last week has been dwarfed by the Fed's move and we think the eurozone is going to have to accept a stronger EUR. 1.10 may be a base in EUR/USD unless renewed strains in the financial system trigger a further cash call on the dollar.

⬇ GBP: Unexpected weakness

We had not expected sterling to fall this far this soon. Perhaps the UK's large current account deficit and financially-driven economy is playing a role here. Risk to 1.20/22 for cable, but we think the losses are temporary.

⬇ EMFX: EM stays on the back foot, short term

Equities to stay fragile, volatility to stay high, emerging market FX to stay on the back foot.

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