

Global FX: Glimmers of hope

Measures taken on both the fiscal and monetary front and signs of reducing USD funding squeeze suggest that global FX markets may be about to exit the period of profound, indiscriminate moves, where the USD appreciates abruptly. This should be particularly helpful for NOK and GBP, which have been vulnerable during periods of the USD funding squeeze



Tentative signs of improvement ...

Although the rally in risk assets stalled overnight and today (equities are down, many EM currencies lower vs USD), the fairly well-behaved price action in FX markets (the decline in selected EM currencies appears modest in the context of heightened volatility which we observed in the past few days and weeks, while G10 FX is up vs USD) suggests things may be tentatively improving.

This is not to say that the downside risks have faded (if anything, the US fiscal stimulus seems to be fully priced in, while there are concerns about the US government having to do even more), but as global governments and central banks have already taken steps in the right direction on the (1) fiscal front; (2) monetary front, and (3) very importantly for FX markets, the USD funding squeeze seems to be easing, the currency market should be about to exit the period of profound, indiscriminate moves, where USD either appreciates or depreciates abruptly.

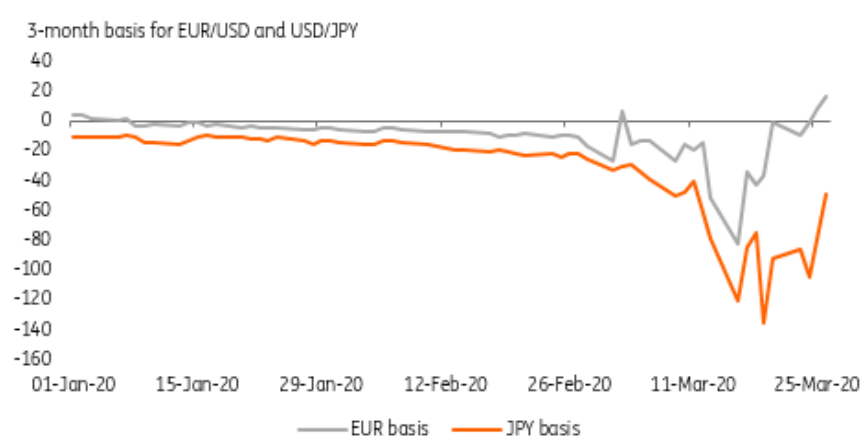
... as the USD pressure appears to ease

As Fig 1 shows, the EUR/USD basis (the gauge for the USD funding squeeze) has now fully recovered and following the Federal Reserve's measures (the central bank offering USD liquidity via the FX swap programme) the EUR/USD basis is back above the pre-USD funding squeeze levels.

A similar trend is seen in USD/JPY basis, which has also largely recovered (also Fig 1). As we argued previously, this was a crucial factor that was exaggerating the currency moves and, if corrected for, should allow for more EUR/USD gains as the unlimited Fed quantitative easing will be allowed to take a toll on the dollar in a better functioning market environment.

[Read our latest FX Talking: I need a dollar](#)

Figure 1: EUR and JPY basis have been correcting



Source: ING, Bloomberg

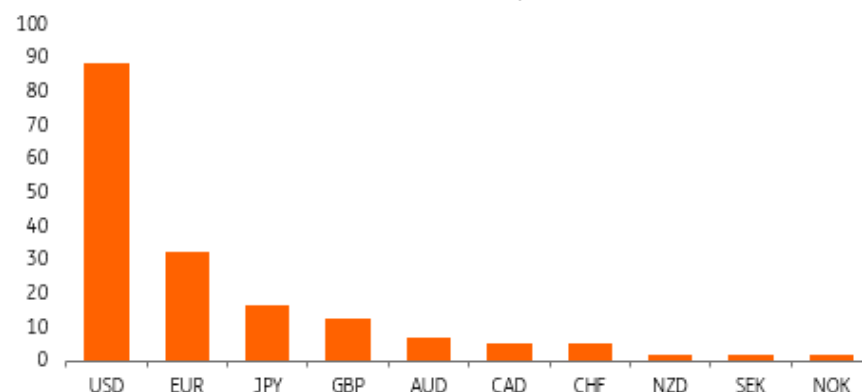
Excessive FX volatility may decline

To be clear, we fully recognise the uncertainty about the persistency and durability of the impact of the Covid-19 crisis on the global economy. But given the measures already taken and USD funding situation improving, we may now move away from the abrupt, many times seemingly irrational FX moves, whereby global currencies depreciated or appreciated abruptly vs USD.

In other words, the currently excessive FX volatility may decline from exaggerated levels. Still, currencies may fall further vs USD, but the fall may be more well-behaved from here vs the abrupt price action so far.

Figure 2: Low liquidity has been an issue for NOK

% G10 FX turnover. As two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%, BIS data



Source: BIS

NOK and GBP might get some breathing room

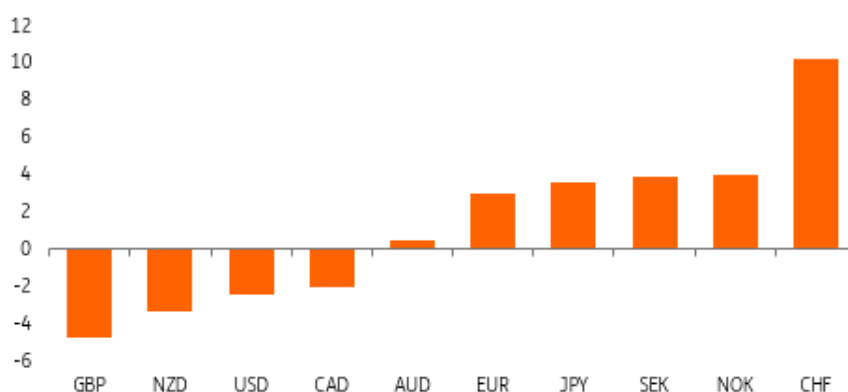
Should the USD funding squeeze pressure start to fade, this should partly benefit NOK and GBP.

NOK has been the key victim of the latest market rout as the krone low liquidity (Fig 2) [heavily exaggerated the currency downfall](#). As for GBP, the currency suffers from the worst current account position in the G10 FX space (Fig 3), and the [external funding needs make sterling vulnerable](#). Both currencies may still decline further vs USD, but the tentative signs of an improvement on the USD funding front suggest a reducing risk of GBP and NOK meltdown during risk-off days.

For NOK, our view that [oil prices will remain depressed](#) for some time suggests that a meaningful NOK rally is unlikely. Rather its downside should be limited from here and NOK should be experiencing less abrupt moves.

Figure 3: GBP has the worst current account position in G10 FX space

Current account balance (% of GDP)



Source: ING, Bloomberg

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