

Tin hat time in FX markets

Continued pressure in global equity markets sees an on-going flight to safety in the FX world. What's different this time is that the market may be starting to price in a fresh round of QE from the US Federal Reserve, which is a clear dollar negative



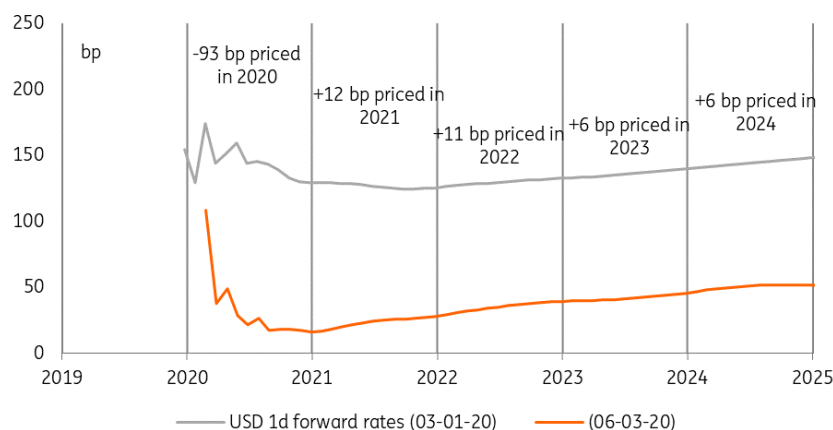
Currency traders in South Korea

Market moves to price a Fed Funds rate at 0.25%

Continued pressure in global equities sees investors rotate into safe-haven assets, particularly in high-quality sovereign bonds, and price an aggressive policy response from central bankers with room to cut.

As you can see in the chart below, our Rates Strategy team highlights how the market has shifted to price the Fed Funds rate at 0.20% later this year – effectively the zero lower bound. Markets are now asking what next from the Fed? Another QE programme? Certainly, the Federal Reserve has room on its balance sheet to resume QE should it so choose, given that its balance sheet is now just 19% of GDP versus the 26% peak in 2014.

Markets shift to pricing the Fed Funds rate at 0.20% within six months



Source: ING Rates Strategy Team

Fed QE would be a game changer for the dollar

QE programmes have been some of the biggest drivers in FX regime shifts over the last decade. The Fed enjoyed first-mover advantage in 2009, with their initial programmes sending EUR/\$ to 1.50. As conviction grew of the ECB belatedly starting a QE programme, EUR/\$ fell 20 cents in 2014.

The spread of Covid-19, its economic impact and the policy response remain highly uncertain, but it seems as though the FX markets are starting to price in the Fed's money printing presses being properly fired up again.

If the Fed were to restart QE, we would expect the dollar to undertake a much deeper decline than the one we currently pencil in (e.g. EUR/\$ to 1.15 in 2Q20). This would really be the US monetary story converging on the zero rates and QE underway among major trading partners.

ECB and BoJ would struggle to resist EUR and JPY strength

In an environment where the Fed re-starts QE, the White House would elevate its Currency Manipulation framework – expecting other trading partners to allow the dollar to adjust to the new environment. This goes to the heart of the US currency manipulation debate – namely that over previous decades trading partners of the US have not allowed their currencies to fully appreciate as part of an orderly adjustment of global imbalances.

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This makes currency intervention to limit local currency strength very difficult indeed. Historically known for their FX intervention, Japanese authorities are unlikely to undertake intervention in USD/JPY before 100. Instead, the expectation is that the semi-official sector, e.g. GPIF, would see good value in \$/JPY at 105 to increase US Treasury purchases. But 105 would remain under heavy

pressure were the Fed to consider QE.

Switzerland has recently been elevated to Washington's currency manipulation Monitoring List and will find it hard to undertake the typical amounts of FX buying seen through prior crises. USD/CHF could, therefore, be embarking on something much more than a trip to 0.91/92.

And for EUR/USD. The ECB cannot match the Fed in terms of rate cuts, nor does it appear to have the appetite for dramatically increasing its APP programmes. Today's move in EUR/\$ suggests investors are just starting to consider this outcome. EUR/\$ is well on the way towards our target in 2Q20. But were the Fed to be called into more drastic action – e.g. starting with a 50bp rate cut at the March 18th meeting and bringing QE a little nearer – then the temporary EUR/USD rally we see could be longer and draw in a discussion of 1.20.

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