FX daily: Some respite for USD amid risk-on pause

The turbulent Sino-American relations have become a catalyst for a pause in the risk-on rally, but to start seeing a reversal we would likely need to see further escalation and above all evidence that trade relations will be impacted

USD: Geopolitical tensions halting the bulls

Sino-American relations are back on a turbulent path, with Chinese authorities taking steps to retaliate against the decision to close the Chinese consulate in Houston. An order to close one of the US consulates in China appears imminent, while President Trump said he won't exclude shutting down more Chinese diplomatic missions.

This situation has been a catalyst for a pause in the risk-on rally, but to start seeing a reversal we would likely need to see further escalation and above all evidence that trade relations will be impacted. For now, markets have once again shown complacency to geopolitical tensions, this time also thanks to the risk-positive combination of EU stimulus, encouraging vaccine trials and the prospect of a new fiscal boost in the US.

With the push from the first two factors wearing off, developments on bipartisan negotiations appear the key to unlocking more upside for risk assets despite geopolitical tensions. For now, there is little hope that an agreement will be reached by the end of this month. All in all, risk assets may start to show signs of fragility after the big bull-run. The US calendar may add to such concerns as initial jobless claims - which are expected to have flattened at 1.3 million – could see a higher reading as the impact of new virus containment measures in some US states has hit hospitality and high-frequency jobs.

From an FX perspective, we see signs of fragility offering a floor to USD for now, although a material escalation in US-China tensions will be required to trigger a true USD rebound, which still retains its medium-term bearish arguments, in our view.

EUR: Likely to stay below 1.1600 today

EUR/USD is testing the 1.1600 resistance after breaking above its 18-m highs. The push from the EU Recovery fund agreement looks over and the pair might not decisively break above 1.1600 for now as geopolitical tensions could offer some support to the dollar. Still, the evidence of fresh solidarity within the EU has clearly unlocked the ability for the EUR to be a key beneficiary of future dollar weakness.

CEE FX is also set to benefit, with CZK remaining our top pick, as highlighted in our latest piece CEE implications from the EU recovery fund.

GBP: Still a laggard

We continue to see GBP as a laggard in the European FX space as EU-UK trade talks continue to prove bumpy and the UK is facing its own fair share of tensions with China, as streaming British football is banned over the Hong Kong-related spat.

AUD: Correction risk rising

Australia's economic and fiscal update showed a concerning picture for the country, with the budget deficit expected at A$185bn (A$100bn more than last year) in the next 12 months, unemployment rising to 9.25% and iron ore prices set to fall.

AUD appears to be shrugging off domestic concerns (including lockdowns), which makes us lean more in favour of NZD in relative-value terms.

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