Dollar bid fades as equity markets stabilise, Powell could reignite bond market turmoil

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GBP

Sterling's price action yesterday was of specific note given its resistance to the broad bid in the US dollar, however, there were periods throughout the session where the pound's defence lapsed and had to recover. The increased resistance, potentially due to front-end Gilt yields rising in tandem with Treasury yields, resulted in further upside in GBPEUR in yesterday's session. With further sterling outperformance visible in this morning's market, focus will be on whether the cross can break its current range to the upside and print fresh pandemic highs. With little on the data calendar, focus will be on bond markets in today's session for the pound and how broader market risk sentiment fares following yesterday's painful equity trading. Outside of economic events, Prime Minister Boris Johnson remains under pressure as a Financial Times article reports that he attended a "bring your own booze" even in the Downing Street garden less than an hour after a senior minister warned Britons that social gatherings were prohibited on May 20th 2020. Such scandals have punished Johnson in the polls and have increased pressure on him from within his own party as many backbenchers focus on the upcoming local elections.

EUR

Volatility was elevated in the most liquid currency pair yesterday as the bond markets' battle with the US 10-year filtered through to the FX space via rate differentials. Unlike JPY, which is also sensitive to back-end US Treasury yields but found strength in declining equity markets and risk-off flows yesterday, the euro sat under pressure for the entirety of the trading session. However, increased demand for the US 10-year around the 1.8% level helped soothe pressure on the euro and led to losses of around 0.6% to be reduced to 0.23% upon close. With very little on the eurozone events calendar today, the focus of the single currency will continue to be on the US yield curve, especially with Fed Chair Powell set to speak this afternoon.

USD

After a fairly muted start to yesterday's session, the cash opening in US equity markets sparked life back into FX markets and resulted in the dollar going bid across the board. With the S&P 500 and the NASDAQ indices trading deep in the red for most of the session, the dollar was supported by risk-off flows as Treasury yields continued to rise and inflict damage to stock valuations. However, with most of the losses in the US stock maket reversing by the closing bell, the dollar's strength also began to fade. Despite this, the greenback still closed the day out on a stronger footing, with just AUD and JPY managing to make inroads over the course of the session. Overnight, the risk climate has stabilised somewhat despite Asian equities trading in the red and US futures pointing to a decline in most indices at the opening bell. Treasury yields have moderated somewhat, with the 10-year unchanged at 1.75% and the front-end just above 0.9%, while the dollar is selling off mainly against pro-cyclical currencies. Today, all of the focus will be on US monetary policy as Fed Chair Powell testifies to the Senate banking committee at his re-election hearing. In prepared remarks, the current Fed Chair has outlined his commitment to keeping inflation in check but has outlined how this recovery is unlike those in the past and therefore policy needs to take these differences into account. Beyond tackling inflation and discussing the speed of the labour market recovery, Powell is expected to speak on climate change, banking regulation, and the trading scandal that saw Vice Chair Clarida resign yesterday a fortnight before his term was due to expire. Given how instrumental Powell's testimony could be, FX traders are unlikely to allow certain currency pairs to trade in wide ranges in the run-up to the event at 15:00 GMT.

CAD

The Canadian dollar fared well in yesterday's risk-off market as it fell only 0.27% against the greenback. This morning, as risk conditions stabilise, the loonie has fully retraced those losses and is back to trading at the top of its recent range against the dollar, highlighting how the impact of front-end repricing is only limited and largely dependent on broader market sentiment. The Canadian dollar has been highly sensitive to US equities since the turn of the year and the US cash open has been a significant turning point in some previous trading sessions. With very little due out of Canada this week, the focus will sit firmly on bond market price action and how US equities trade in relation to the dynamics in rates markets.