

# Dollar downside likely to prove temporary

25th March 2022

## GBP

Following Wednesday's budget announcement, volatility has dried up in GBPUSD. Yesterday's release of March's preliminary PMIs saw the services index surprisingly advance from 60.5 to 61.0 despite the onset of the war in Ukraine and the concerns over the rising cost of living in the UK. The increase in the services index almost offset the decline in the manufacturing measure, which fell from 58.0 to 55.5. Overall, the composite PMI slightly moderated from 59.9 to 59.7. Despite the data, the pound got dragged slightly lower against the dollar yesterday as concerns over growth conditions in Europe continued to dominate. This morning, GBPUSD trades flat upon the European open despite the miss in February's retail sales data, which was published at 07:00 GMT. Retail sales volumes including petrol fell 0.3% MoM in February, undershooting consensus of a 0.7% gain. While some retailers pointed to the trio of storms over the course of the month "Dudley, Eunice and Franklin" to explain the reduction in spending, the cost of living crisis is likely to continue weighing on consumer spending over the coming months. Sterling's limited reaction to the data is indicative of the limited volatility in the pair around current levels.

## EUR

The broad slump in European equity indices yesterday weighed on the single currency over the course of the session, although the overall move lower in EURUSD was limited upon yesterday's close as gas prices stabilised and speculation over EU sanctions on Russian oil proved unfounded. Treasury yields continued to dominate price action in the FX space, with spreads against eurozone and Japanese bonds keeping the dollar buoyant, while growth concerns also reverberated around European assets. With Russia threatening to renege on contracts priced in EUR and USD in order to require payment in RUB, concerns over temporary access of Russian gas now weighs on the eurozone's growth profile. Overnight, senior officials stated that US President Biden will announce a deal to help Europe replace Russian gas imports this morning, which has aided the bounce back in EURUSD. On top of that, concerns over "vertical escalation" in the Russia-Ukraine war "the use of chemical or nuclear weapons as a means of escalation" were moderated after Axios, citing the chief of staff to the Ukrainian President, broke news that there was "careful optimism" in peace talks. This morning, EURUSD trades almost a third of a percentage point higher due to the positive developments outlined, however, we are sceptical that the recent bounce back marks an inflection point for the currency pair and continue to see risks tilted to the downside. IFO expectations data out of Germany this morning is expected to follow a similar suit to that of yesterday's

preliminary PMI data, which saw confidence indices for 12-months ahead reduce as inflationary pressures sit close to record highs.

## USD

The dollar continued to split the G10 currency board in yesterday's session as it rallied against the euro, pound, kiwi dollar and Japanese yen, but sustained losses against commodity currencies AUD, NOK and CAD along with SEK. The main driver of this bifurcation in the dollar was commentary around commodity sanctions. In response to President Putin's statement that all Russian gas will be priced in RUB, speculation arose around the possibility of EU leaders imposing sanctions on Russian crude exports, which has larger repercussions for Russian government revenue. This saw increased volatility in global oil indices and European gas prices, with WTI touching \$116 per barrel at one point before closing lower on the day. This morning, with the Bank of Japan standing on the sidelines as 10-year Japanese bond yields trade above 0.23% " a level that saw the central bank intervene back in February to defend its +/- 0.25% target on 10-year yields " the Japanese yen has rallied over half a percentage point, bringing the USDJPY rate down from yesterday's multi-year high. In combination with the JPY rally, other low-yielding currencies such as EUR and CHF have started this morning's session on the front foot. However, with markets likely to continue betting on 100bps of hikes by the Fed over the next two meetings and front-end Treasury yields likely to continue playing catch up to money market pricing, we expect today's dollar downside may be temporary in nature. On the roster today for the US is Fed member's Daly, Williams, Barkin and Waller.

## CAD

The Canadian dollar strengthened slightly against the greenback on Thursday, posting a middling performance relative to its G10 peers. The loonie's trading range was quite tight with a difference of less than 80 ticks from peak to trough. Risk sentiment was positive, the S&P 500 closed 1.43% higher, VIX down 8%, and bonds selling off across major international markets. Equities and yields were the most favourable factors for CAD as the Canadian 2Y yield rose 10bps, outpacing US bonds by 2bps, to put the US-Canada 2Y yield differential in negative territory for the first time since the Fed's hawkish shift at the start of March. Crude oil could have contributed to capping CAD's performance with WTI down 2.25% on the day after a brief spike higher helped commodity currencies. Today, Bank of Canada Deputy Sharon Kozicki speaks at 16:45 GMT/ 12:45 ET, on "a world of difference: households, the pandemic and monetary policy.

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