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USD reverses recent surge higher as policy action buys time

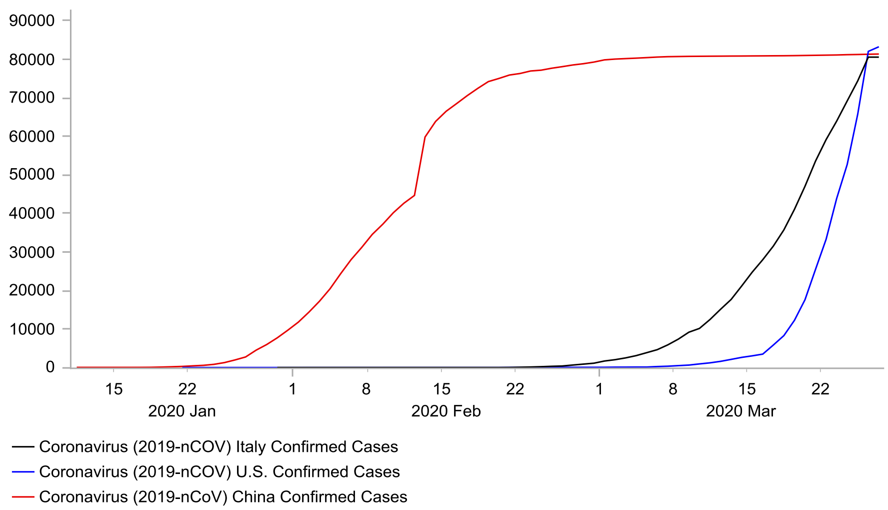
27th March 2020

USD: Policy action only provides time

The sharp reversal of the US dollar yesterday was clear evidence that the deluge of measures from the Federal Reserve to address USD liquidity problems were finally becoming more successful. The USD 2trn fiscal stimulus agreement was secondary to that fact while the limited reaction to the shocking surge in initial claims was also an indication that, at least for now, the markets are conditioned for the flow of dreadful economic data that is coming our way.

A key component in investors seeing evidence of USD liquidity measures working was the sharp bounce in the JPY basis yesterday. Cross currency basis in EUR and GBP had already bounced sharply in previous days but the JPY basis had not followed – until yesterday. JPY basis has now reverted to something a little more normal and that development likely encouraged market participants that wished to sell dollars to start doing so. The USD swap lines are playing a role here – indeed EUR and GBP basis have flipped to those currencies being at a premium over the US dollar. Given the euro is a negative yielding currency that is saying a lot about the

US COVID-19 CASES NOW THE LARGEST IN THE WORLD



Source: Bloomberg, Macrobond & MUFG GMR current availability and cheapness of the US dollar. The New York Fed last night released data through to 25th March for swap totals taken up in daily auctions that now take place with the ECB; the BoJ; the BoE; the SNB; and the BoC. The usage through the ECB is greatest – USD 116.2bn, the BoJ utilised USD 67.2bn' the BoE used USD 19bn, and the SNB USD 3.6bn. The BoC did not tap the USD swap facility. So a total of USD 206bn of liquidity through these facilities was taken up – a significant total that helps explain in part the reversal of USD strength.

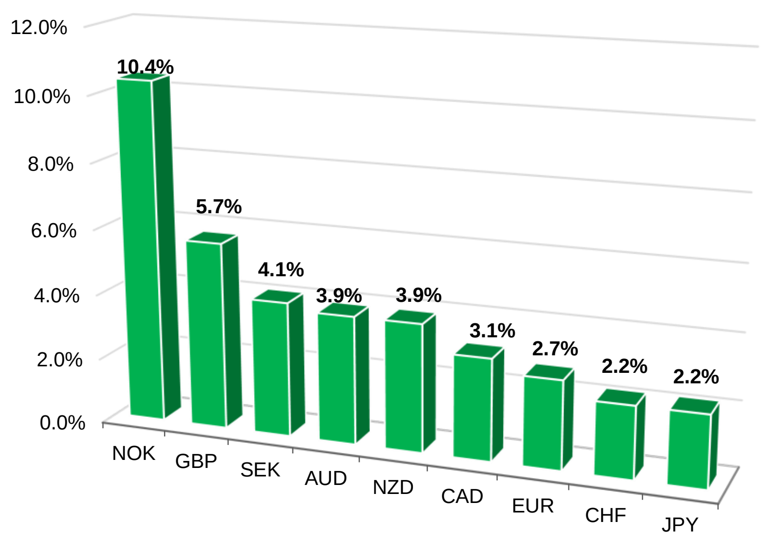
While we believe the ultimate direction of the dollar following this crisis will be down, we can't be complacent in assuming this is now under way. That would be premature. The Fed steps and the government actions have bought time in order to assess two things. Firstly, whether economic lockdowns will curtail the spread of COVID-19 and secondly whether the fiscal stimulus policies are of appropriate size and design to address the economic impact of the virus.

On that front, COVID-19 data and the extent of economic weakness in the incoming economic data along with evidence of how quickly governments are actually implementing policies will be key. The 3.28mn increase in initial claims yesterday was indicative of the horrible data to come. Furthermore, the COVID-19 data from Europe and the US remains worrying. The Italian rate of new cases picked up from 7.5% to 8.3% and in the US from 24.4% to 25.3% – still the 5day average in the US is now slowing but remains elevated. So we need to wait and see before a trend of USD weakness probably becomes established.

GBP: Playing catch-up

We are now seeing the predictable reversal of G10 FX performance on the back of the broad depreciation of the dollar in response to the liquidity measures by the Federal Reserve and the government measures on top. Taking FX performance since this crisis began to impact equities (from the record high on 19th Feb) to the end of last week NOK was by far the worst performing G10 currency, down a huge 21%. No surprise then that this week it is the top performing G10 currency – up 10.4%. AUD, NZD, GBP were the next three worst performers and this week GBP is 2nd to NOK in performance versus the dollar (+5.7%).

G10 FX PERFORMANCE THIS WEEK

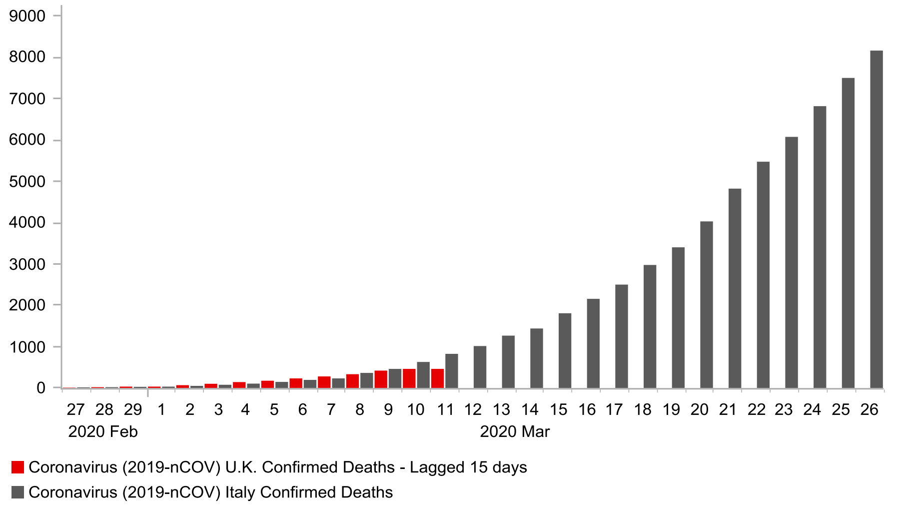


Source: Macrobond & MUFG GMR, as of 0745 27th March

That doesn't surprise us and assuming these more favourable financial market conditions can now last for a period to assess how the spread of COVID responds to lockdowns, GBP could be rewarded further by the economic policies of the government to target more specifically the protection of employment. While job losses are inevitable, the coverage of 80% of wages for private sector employees up to GBP 2,500 per month will potentially be very powerful in protecting employment. Yesterday, Rishi Sunak went further by announcing measures to protect the self-employed. The announcement yesterday was more widespread than had been reported with the government stating that 95% of self-employed would be covered by the support package. The support would cover 80% of wages measured by the average income over the last three years taken from self-employed tax returns.

Like elsewhere COVID data in the UK will be important for GBP. There was some reassuring words from the renowned expert in the UK – Professor Neil Ferguson of Imperial College – informed MPs in parliament on Wednesday that he believed the NHS would cope and that a peak could be seen in two-and-a-half to three weeks time. However, the data yesterday did not serve to reinforce an optimistic view. There were 2,129 new cases of COVID-19 reported with 115 new deaths – both the largest daily increases. However, the 5-day average percentage change in new cases stands at 18.4%, a new low. UK COVID-19 growth in deaths remains elevated relative to most of Europe and hence unfortunately there is no cause for optimism at this precise point in time.

ITALY COVID-19 DEATHS VERSUS UK (LAGGED 15 DAYS)



Source: Macrobond, Bloomberg

EUR: Disappointment from Europe

The European Council meeting yesterday was expected to sign-off on a deal that had been reached at the Eurogroup meeting that the ESM would be utilised to finance country-by-country fiscal spending of up to 2% of GDP but there was nothing confirmed at yesterday's meeting. That might not be anything alarming. After all, Chancellor Merkel stated yesterday support for utilising the ESM. However, Austria had expressed opposition to any mutualisation of debt across Europe. The equity markets have rallied hard in recent days, financial market volatility has come and general market conditions have improved. We hope this lack of formal sign-off is not a sign that disagreement forestalled progress on this. Complacency at this early stage would be a concern. We all recall the difficulty of getting agreement during the euro-zone debt crisis and often it was only when a feeling of being on the brink, did key steps get agreed. Hopefully European authorities are not repeating that now as confidence could reverse sharply – as we state above, the steps taken so far by central banks and governments have only bought some time.

KEY RELEASES AND EVENTS

Country	GMT	Indicator/Event	Period	Consensus	Previous	Mkt Moving
SW	08:30	Retail Sales MoM	Feb	--	0.9%	!!
IT	09:00	Consumer Confidence Index	Mar	100.5	111.4	!!
IT	09:00	Manufacturing Confidence	Mar	88	100.6	!!
IT	09:00	Economic Sentiment	Mar	--	99.8	!!
US	12:30	Personal Income	Feb	0.4%	0.6%	!!
US	12:30	Real Personal Spending	Feb	0.2%	0.1%	!!
US	12:30	PCE Core Deflator MoM	Feb	0.2%	0.1%	!!
US	14:00	U. of Mich. Sentiment	Mar F	90	95.9	!!!

Source: Bloomberg

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