FX Monthly Report

March 2021

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Research Desk
research@sucfin.com

Press Enquiries
press@sucfin.com

Authors:

Geordie Wilkes
Head of Research

Daria Efanova
Research Analyst

Daniel Henson
Deputy Head FX

Nimit Khamar
FX Desk Broker

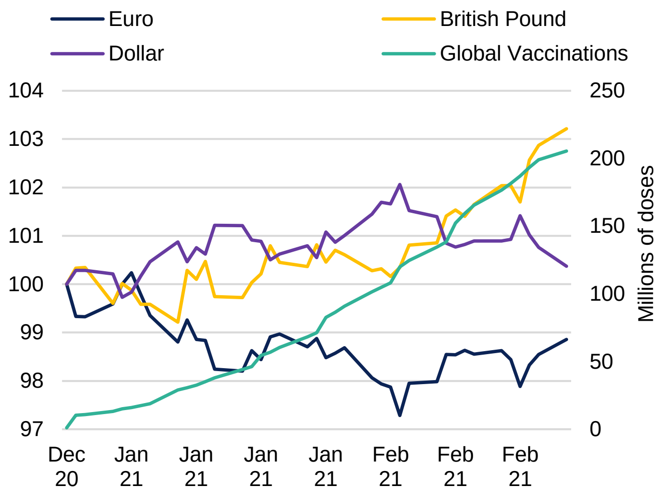
Chris Husillos
FX Desk Broker

Macro

Economic policy has been rewritten, and we expect governments to maintain higher levels of debt for longer; this is not an issue if economies run with higher economic growth. However, the dollar trend is firmly intact; we expect this to continue given the amount of stimulus released and the Fed's policy of allowing inflation to be higher for longer with low real interest rates. The gap between real and nominal yields suggests investors expect US inflation to rise, other central banks have not followed the Fed to increase their inflation target, and their minimal support for the dollar indicates there is much further for the dollar to fall. The recent sell-off in stocks is expected to be short lived and buybacks back in the fray, we expect capital to remain in cash equities in the near term. However, the movement in long-dated bonds has captivated the market; the gap between the US 2yr and 30yr has reached the highest level since October 2016 at 203.715pps, as of February 22nd. The curves steepening can also be seen with the spread between the 2yr and 10yr yield, which stands at 123.95pps. The rise in real yields has also been prominent; the real 10yr yield based on Core CPI had risen 50% since the beginning of the year to -0.34%, a rise of 78% from the March 2020 low when real yields stood at -1.55%.

Major Currencies vs Global Vaccination Rates

Bullish sentiment for GBP is off the back of strong UK vaccination data.



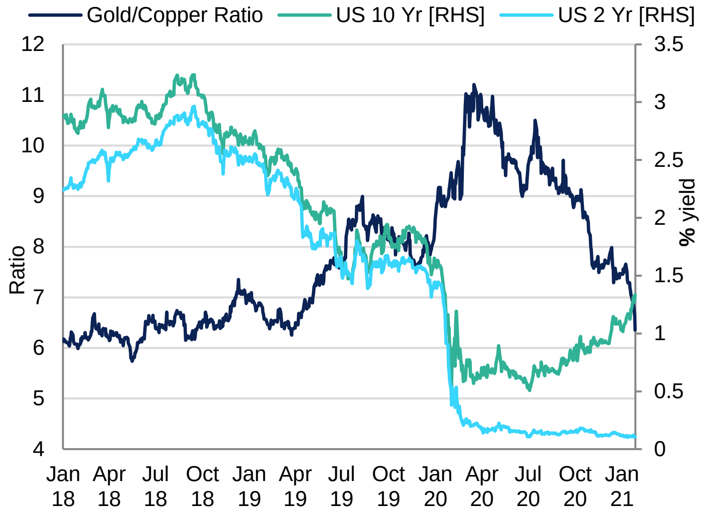
Source: Bloomberg, Sucden Financial

There is certainly more interest in commodities than in previous years. While we have our doubts about a super cycle, it may be more applicable for metals due to the green economy, we expect gains to subside as stimulus dries up. Since the beginning of February, copper prices have rallied 16% as of 22nd, as risk appetite from the investors improves, a weaker dollar, inventories decline, a positive demand outlook in the short and long run, and the inflation trade is at the heart of financial markets causing inflows into commodities. The gold/copper ratio has declined from 11.206 in March 2020 to 6.33 as of February 22nd, the lowest level since 2019. The rise in commodity prices has come at the detriment of gold and will prompt cost-push inflation in the long run; this presents a threat. While we do not envisage any changes in interest rates any time soon, the implied policy rate in September 2021 is 0.09%, with global government debt at record highs following COVID-19 and Central Bank balance sheets elevated, the prospect of higher rates in the long run to suppress inflation will be a worry for countries that hold large amounts of dollar-denominated debt.

Again, we do not expect the Fed to raise rates in 2021 or taper bond buying until the recovery is confirmed; with the vaccine rolled further, employment is rising, and consumer spending patterns return to their previous patterns.

US 2yr vs US 10yr vs Gold/Copper ratio

The gold/copper ratio has decline as 10yr yields rise.



Source: Bloomberg, Sucden Financial

Vaccination rates in major economies are generally ahead of the LEDCs; this highlights the increase in inequality across the globe. Higher vaccine administrations will translate to more robust economic data sooner as restrictions are eased, leading to higher full-time employment and more 'normal' consumption patterns. Consumer and business confidence in these regions are rising, and as restrictions reduce, employment improves, and business operations progress, earnings potential will also grow, inflation is a threat. Economic data will improve in major economies as the vaccination is rolled out, and lockdown restrictions are eased. Year on year data points will see significant increases from 2020 due to the first lockdown, but investors would do well to look at the absolute value to identify where economies are compared to previous years. In the UK, investors are looking through the lockdown, poor economic data and Brexit towards the high vaccination rate and this has supported cable in recent weeks.

EURUSD

In 2020 we saw the EURUSD rally, as funds flowed into the bloc and out of the US due to President Trump's poor handling of COVID-19, declining yields and the large amounts of stimulus from the US government prompting the dollar to depreciate. However, Europe is behind the vaccine program curve, which could drag on the currency in the next month. The correlation between the daily change in EURUSD and the daily vaccination rates of Germany, France, Italy, and Spain combined has been volatile but, as of February 22nd, shows a weak positive correlation at 0.352. While we expect Europe to catch up, supply chain difficulties and inter bloc disputes have weighed on euro sentiment. Germany and France have only vaccinated 5.3% and 4.9% of their population, respectively, compared to 17.3% in the US and 24.7% in the UK, as of February 17th. These rates are all that matter now, but we also note the spread between the 2-year German Bund and the US 10-year has been increasing and reached 243pps of February 22nd. Rising yields in the US compared to Europe may cause EURUSD to lag in the near term, even if vaccination rates and economic data in the bloc improves.

We do not change central bank policy in the next month or until the recovery is a lot more pronounced. Yes, economy data is more optimistic, but there is much slack on the global economy, and stimulus measures continue to cloud the outlook, with the difference between Wall Street and main street significant. We could even see the ECB increase the TLTRO with the most favourable interest rate extended, easing the pressure on banks' negative rates. The negative deposit rate's impact is the distribution of wealth from the ECB to banks, which will help lend in the long term. Positioning data is also for the EUR is also likely to be another headwind to the currency in the near term; we expect EURUSD to weaken in the near term back towards 1.20. We see EURUSD trending higher in the long run with Mario Draghi, now Italy's prime minister, but we expect the EUR to struggle for the next month.

EUR Desk Comment

Despite our expectations of a Dollar negative narrative until Q4 we believe this cross will remain broadly rangebound. Expectations of the US economy returning to normality sooner amid vaccine rollout, differing levels of stimulus and booming US equity markets are all supporting factors. The Euro is increasingly being used as a funding currency for some risk on plays as yield differentials between US and European bonds widen. The desk does not foresee any catalysts on the horizons that could change this and therefore expect the Euro to continue trading in the 1.1850/1.2350 range.

USD Desk Comment

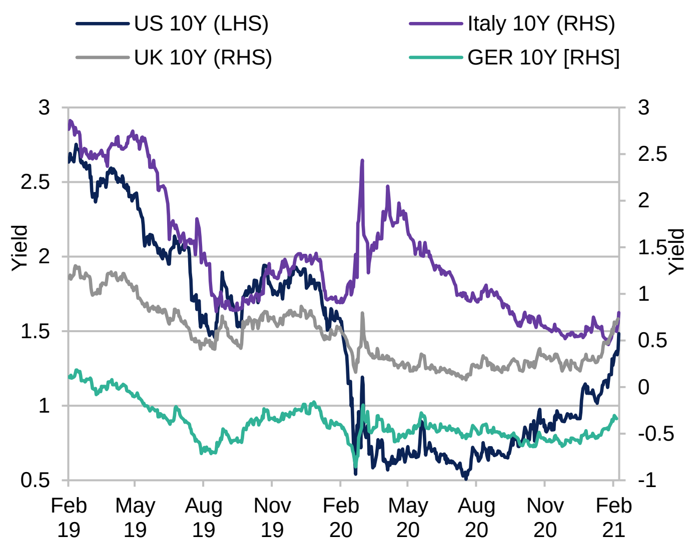
This year we have seen net speculative Dollar short positions reduced, as some of the factors behind the Dollar's selloff in 2020 recover significantly, most notably Bond yields. It is our belief the markets are still likely on the path of reflation as Powel re-affirmed the Fed's commitment to a dovish monetary policy. This, along with the looming fiscal stimulus package from Biden and vaccine optimism as distribution accelerates, are likely to give the global economy a big boost. Hence, we expect the Dollar to depreciate especially against EM and commodity-based currencies as the general risk rally continues.

Moving forward to Q2, inflation readings will rise, but are unlikely to weigh on any monetary policy decision as we expect these to be only temporary due to base effects of the fall last year and amid ample spare capacity in the US.

We expect the Dollar to remain on the back foot until Q4 2021 before turning once again as effects of monetary and fiscal stimulus start filtering into economic growth. Nominal and real rates are still relatively low, but the risk to Dollar bears will be if these rates continue rising, which could convince markets the FED will have to act sooner. Fear that any fiscal tightening could hinder the global economic recovery would be detrimental to investor sentiment; we expect this change in sentiment to come towards the end of 2021. The rate expectation picture has already changed compared to last year with markets now pricing in a rise sooner and quicker compared to last year's expectations.

Developed Economy 10 Year Yields

Yield curves have steepened but European yields are lagging US yields.



Source: Bloomberg, Sucden Financial

GBP

Sterling bulls remain dominant as investors are looking through the poor economic data due to the lockdown and Brexit risk. Cable has been well supported as a result of the vaccination rate. The roadmap outlined by Boris Johnson should give businesses time to prepare. However, they may be cautious to hire full-time employees until data suggests that another lockdown is not likely. This may keep employment figures lower, but we expect unemployment to increase once furlough schemes are stopped. This is not something the market will consider in the coming month, and we expect traders to be transfixed on the UK vaccination rate. The UK economy's vaccination rate and roadmap could present an upside to economic data, but the key remains the BOE. We do not expect negative rates, but this will suppress rates if it is still in the conversation. However, the yield curve is steepening; higher rates than European countries could keep sterling in the bull run for longer. We expect sterling to remain bullish; positioning data for cable shows non-commercials holding a net long of 22,211 as of February 16th. The z-score of the current position is 1.2, and the historical maximum is 1.51, which suggests the capacity to add to exposure and fuel gains in cable. We expect dips to be well bid.

GBP Desk Comment

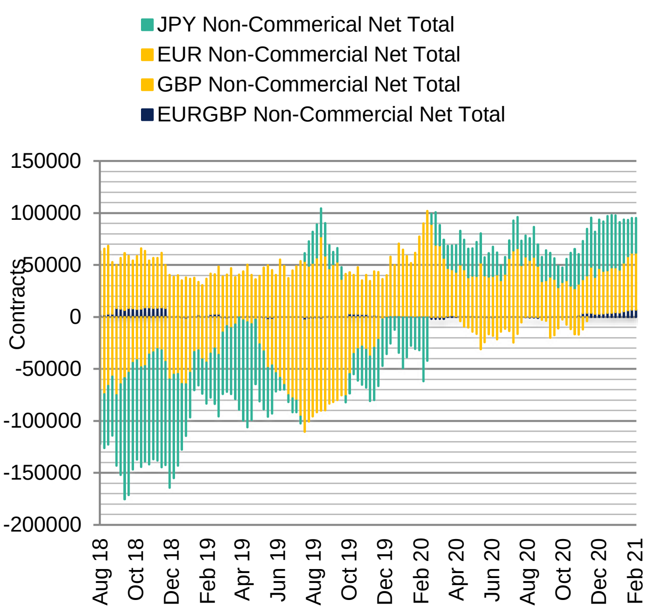
We favour GBP to continue appreciating against the dollar but believe any rise could be limited over the coming months. Vaccine narrative has been one of the reasons behind sterling outperforming over the last few months. However, we believe this is now reflected in prices as cable rises above the 2-sigma territory so any further gains could be limited for the time being.

Nonetheless, foreign investment had all but dried up during the prolonged periods of uncertainty surrounding Brexit and we believe as the UK economy emerges from lockdowns investors will return to these shores giving GBPUSD a further push higher to the 1.50 / 1.55 area by the end of the year. We would expect any corrections lower to be supported and see 1.3800 and then 1.3500/1.3550 as a good area to buy. Furthermore, given our view on Euro we would expect EURGBP to continue lower and test the 0.83 support levels and moving closer to 0.76 area by end of the year.

CNY

Major Currencies Investment Funds Positioning

Investment funds have added to their net position



Source: CME, Sucden Financial

China's currency benefited from how the government handled COVID-19 and the extensive stimulus measures, which boosted raw material demand, and economic data. The economy benefitted from the supply chain disruptions globally; manufacturing shifted back to China, buoying the economy and currency. Corporate demand for the currency was strong, but China's foreign exchange settlement surplus on the spot market reached $40.8bn in January, down from $66.6bn in December. We expect the CNY and CNH to strengthen against the USD in the coming month. The risk reversal rate reached 0.765, which indicates CNY strength. Following Lunar New Year, economic activity has restarted strongly, and we expect this trend to continue in the near term. A longer-term threat to the economy is the government's reduction in the financing, especially following new regulations regarding financing in the property sector. The economy's infrastructure and property sectors are a large proportion of China's economic growth, and a slowdown in these sectors could cap GDP, especially if consumer saving rates remain high and expenditure is limited.

Gold

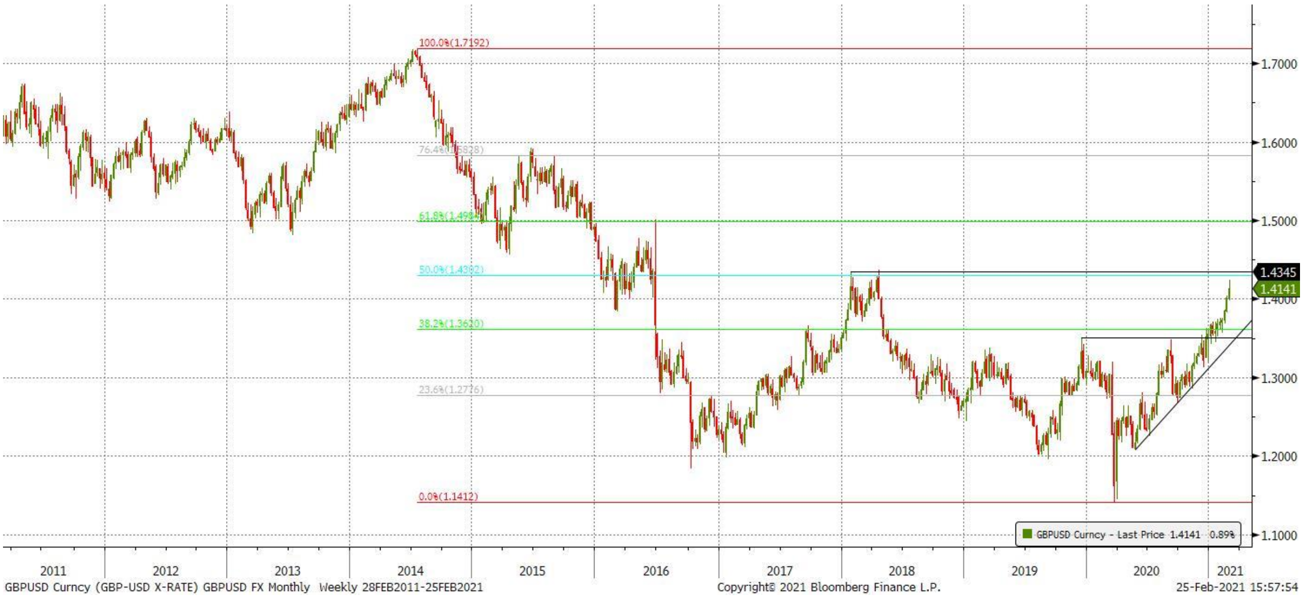
There is much talk about gold falling victim to the rise in cryptocurrencies and especially bitcoin. While there is likely to be some truth to this, we expect most of this remains true for retail volumes. More banks and multi-national corporations recognise bitcoin as an asset, but a large proportion of the flows remain from retail investors, and gold is the preferred long-term hedge. Known holdings of gold ETFs have declined significantly in recent weeks and days, and this outlines declining appetite for gold in the coming months. Risk appetite amongst traders has increased, and even though debt levels are high, unemployment is high and will continue to rise in the near term, and gold struggled so far in 2020. However, yields are starting to grow, as the back end of the curve steeping and investors expect inflation will appear on the horizon. While this may be true, we do not expect this to materialise in the near term, and as a result, gold may struggle on the upside as investor sentiment is firmly risk on and retail flows favour cryptos. Central bank buying has been muted this year, but as inflation starts to rise, we expect to see more gold purchases from CBs. Stocks are elevated, and economic data will show improvements in the coming months which may drag on gold, especially as yields start to rise. The speculative net position for gold stands at a net long of 235,000 as of February 19th, but we expect this to begin to decline in the coming weeks, triggering further losses for the non-yielding asset.

Silver

The silver market fell victim to a large influx of retail investors earlier this month. However, the outcome was not what they expected because silver traders very differently from stocks. While the fundamentals for silver remain bullish in the long run, the 10% spike in one day was a gift for producers who sold into the rally. The net position of managed money was already long going into the retail rally, which seems slightly counterintuitive considering their original agenda. However, silver ETF holdings have stayed elevated, and global ETF holdings are greater than a year's supply; ETP holdings have continued to rise as well, reaching 1.18bn ounces as of February 3rd. Physical demand for silver is strong, and this trend is expected to continue in the long run with the green agenda, but the supply of silver is subdued, which provides tailwinds to silver. The prospect of rising inflation could prompt appetite for precious metals and, therefore, silver, but with nominal yields rising, there is a greater emphasis on yields, base metals, and stocks at this time. There remains a strong upside for silver. However, option premiums were expensive due to the retail influx and these rates are expected to soften slightly. $30/oz is the key psychological level on the upside which we expect to break in H1 2021. However, the near-term momentum is against the precious metal.

Technical Charts

GBPUSD



After making lows in March 2020, GBPUSD has been trending higher breaking resistance @ 1.35 late last year. On the upside the market is likely to meet resistance @ 1.43 (50% fib of the move from 03/16 to03/20) and at 1.4382 (High from April 2018). We expect market to consolidate here for a few months before taking its next leg higher and testing 61.8% fib / 1.50 psychological level. Downside support comes in the form of trendline and support @ 1.35. A sustained close below 1.35 would be needed to change our upside biases.

EURUSD

EURUSD has been consolidating after making highs at the start of year @ 1.2348. We expect market to continue consolidating between 1.195 -1.2348 with a break of this range determining the next move. On the upside a sustained close above 1.2348 could see EURUSD test 1.2553 highs from 2018 and then top of the channel. On downside a break of 1.195 would see EURUSD consolidate in broader range between 1.16 -1.2348.

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Coffee Investment Research

This report drills down into the detail of the coffee market and is produced three times a year, we also produce shorter more concise updates. We undertake a macroeconomic assessment of major consuming and producing regions before analysing the recent earnings reports from Starbucks, Nestle, Luckin Coffee, Dunkin Donuts, and Costa. This helps us highlight new sales and marketing techniques and any consumption changes, which has been particularly popular during COVID-19. The largest chunk of this report is where we assess the Supply and Demand outlook using our primary data for the coffee market and where we apply our fundamental models. We showcase our crop forecasts and highlight any changes before providing prices forecasts and trading strategies with futures and options.

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Contact our team for further information.

Tel: +44 20 3207 5294
Email: research@sucfin.com
www.sucdenfinancial.com

Disclaimer

United Kingdom
Sucden Financial Limited
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Tel: +44 (0)20 3207 5000
Email: info@sucfin.com

Russia
Sucden Financial Limited
Sucden Financial (Russia)
Representative Office
Orlikov per. 3 ‘B’
Moscow 107139

Tel: +7 495 796 96 40
Email: russia@sucfin.com

Hong Kong
Sucden Financial (HK) Limited
Unit 1001, 10/F
Li Po Chun Chambers
189 Des Voeux Road Central
Hong Kong

Tel: +852 3665 6000
Email: hk@sucfin.com

USA
Sucden Futures Inc.
12th East 49th Street
27th Floor
New York, NY 10017
United States

Tel: +1 212 859 0296
Email: ny@sucfin.com

sucdenfinancial.com