



FX Markets Not Immune to Vaccines

There were two significant moves on currency markets last week, with the euro dropping back below 88p versus sterling and \$1.20 against the dollar. Strangely, the moves were probably more about the UK and US currencies than the euro.

There is growing optimism that the rapid roll-out of Covid vaccines in the UK will allow restrictions on activity there to be eased considerably in the months ahead, leading to a sharp rebound in activity. Ten million people in the UK have already been vaccinated, or 15% of the population, which is well ahead of elsewhere.

A relatively upbeat Monetary Policy Report was published by the Bank of England last week. The Bank sees GDP growth in the UK picking up to 5% in 2021 and 7.25% in 2022, following the estimated 10% fall in output last year. Furthermore, the Bank no longer sounds like it will loosen monetary policy any further, especially in terms of lowering rates. Thus, markets are no longer pricing in a move to negative interest rates in the UK.

Sterling did not show much initial reaction to the EU-UK trade deal concluded at Christmas. However, it has started moving higher against most currencies over the past month. EUR/ GBP fell below the 88p level in the aftermath of the BoE meeting, for the first time since last May. However, there is strong support for EUR/GBP in the 86-87p range which could make it difficult for sterling to make large additional gains against the single currency.

Meanwhile, the dollar has performed strongly over the past month having weakened significantly during the second half of last year. It has risen by some 2% against the other major currencies since early January. It had been flagged that the dollar could bounce in early 2021, as the market was very short the US currency coming into the New Year.

A marked rise in long term US bond yields has also been supportive of the currency, as have recent, better-than-expected data on the US economy. Having dipped below \$1.20 last week, the euro could lose some more ground in the near term, given the market is still short the US currency. There is considerable support for the single currency, though, at between \$1.16 and \$1.18, so the euro's downside may be limited from here.

The slow roll-out of Covid vaccines in the Eurozone is proving a headwind for the single currency, given it is seen as holding back an economic recovery in the region. However, with more vaccines expected to come on stream in the months ahead, the vaccination programme in the EU should gather pace as the year progresses.



More broadly speaking, the IMF sees the recovery in the global economy picking up momentum during 2021 and in 2022 as vaccines become more widely available. This should boost risk appetite in financial markets and lessen the appeal of safe-haven currencies like the dollar.

Thus, while recent dollar strength may be sustained in the near-term, the currency could come under downward pressure again if a sustained, robust global economic recovery takes root later in the year. For sterling, there are also medium term risks as the downside consequences of Brexit become more apparent for the economy.

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