Loonie drops to 5-month low as OPEC+ decision and Covid concerns take toll

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CAD

The Canadian dollar wasn't exempt from the risk-off rout in yesterday's trading session. The loonie sat second from the bottom in the expanded majors against the US dollar, beating just the Brazilian real over the course of the day, as it was hit by both a deterioration in risk sentiment and a lower oil price. Additionally, the Canadian dollar's correlation with the US equity market didn't provide any support. Upon close, the USDCAD pair rose over 1.2% to place the loonie at its weakest level since February 26th. Today, the loonie continues to weaken with the rest of the G10 currency board, but a stabilisation in WTI around $67 per barrel is providing some support for the Canadian dollar. A rebound in US equities may provide a further tailwind, but thus far the recovery in commodities, fixed income, and equity markets doesn't look to have transgressed into G10 FX markets.

USD

It was armageddon in markets yesterday as multiple narratives combined to weigh on risk sentiment across all asset classes. Firstly, the prominence of the third wave of cases internationally stoked concerns that global demand won't recover as aggressively as previously expected. While rising case counts in the southern hemisphere have largely resulted in lockdown measures being tightened and extended, heavily vaccinated nations in Europe and the US are also having to navigate the complications of the more transmissible Delta variant. On top of this, geopolitical tensions have been rising after the US accused the Chinese government of sponsoring domestic gangs in their cyberattacks against thousands of organisations including the likes of China. To add to the mix, OPEC+ also announced plans to increase oil production, which weighed on crude markets and spilt over into broader commodities. With the narratives combining, it was one-way traffic into the US dollar yesterday, along with US Treasuries and other safe havens like the Japanese yen. US equities were hit hard, with the S&P 500 closing 1.6% lower and the Dow Jones falling over 2%. Growth and tech stocks continued to outperform cyclical/ value stocks, with the Nasdaq limiting losses to just 1.06%, but even the hottest equity classes of the year weren't safe from the deterioration in risk appetite. The US 10-year fell over 7 basis points open-to-close. The 10-year Treasury now yields its lowest amount since February at 1.1888%. The flight to safety saw investors flood into the US dollar on a broad basis yesterday, with the greenback only sustaining losses against the Japanese yen and Swiss franc. Today, markets have opened in a more sanguine nature, with US equity futures and yields stable, but further concerns were felt in Asian equity markets as cyclical stocks like energy led declines. In the FX space, the playbook looks to be similar to yesterday's, with the dollar remaining firm across the G10 space and higher-beta currencies leading declines. The question market participants will be asking in the short-term is how far this dynamic can run, which will largely be dependent on the threat the Delta variant poses to the global economic recovery, as opposed to whether a retracement is likely in the coming days.

EUR

While many other procyclical currencies saw losses yesterday, the euro held up against the US dollar and even managed to outperform other cyclical currencies in the G10, arguably as EURUSD is more sensitive to movements in US yields due to the large policy diversion between the Fed and the ECB in terms of interest rates. This led to EURUSD reaching session highs before it pared gains to close only slightly lower on the day. With Thursday's European Central Bank meeting being the key event of the week and many expecting the central bank to strike a dovish tone following the latest strategy review, it may be difficult for EURUSD to find good reasons to rally significantly ahead of the meeting unless risk sentiment improves or markets view additional stimulus from the ECB as positive for the euro, as it means downside risks to the eurozone economic outlook will subdue. Meanwhile, surging virus cases across the bloc still dominate headlines with cases in the Netherlands and Spain having reached levels last seen in Q1, although the increases still remain below UK figures. In the background, focus is back on HUF and PLN after the EU's top court said both Hungary's and Poland's judicial system clashes with EU law, putting both countries' tens of billions of grants from the EU recovery fund at risk.

GBP

While a stronger US dollar has been weighing on the majority of currencies across the G10 space since yesterday, sterling has little reason to be an exception to the rule as several virus-related narratives continue to put pressure on the pound. England ended virus restrictions starting Monday, but this comes just as cases are increasing rapidly. The UK added more than 54,000 new cases on Saturday and over 47,600 on Sunday, while Monday's increase of nearly 40,000 marks the highest record on a Monday since January. The US responded to the rise in cases in the UK by warning US citizens to avoid travelling to the UK, and boosted its travel alert to "very high". Different from Q1 this year are the hospitalisations and deaths, as these are running at much more subdued levels than previously seen given the country's vaccination rate. The deterioration in the health backdrop may still have economic implications though as it could result in consumer hesitancy in the interim. Additionally, the probability of tighter lockdown measures in the future can't be discounted fully, as highlighted by the implementation of a vaccine passport for certain activities come September. The UK's health situation and the effect it has on the healthcare sector will be in scope for markets as they assess the ability of nations to fully reopen given high levels of vaccinations. In the short-term, however, the full reopening of the UK economy is yet to boost sentiment around UK assets. Sterling may additionally be held down by comments from Bank of England PMC member Haskel and incoming member Mann, who underscored their views surrounding the transitory nature of the current inflationary impulse, countering the recent hawkish utterances from the BoE's Saunders and Ramsden.

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