G20 in a New Era: In Search of Common Ground - Global Exchanges Transcript

Greg Anderson:

Hi, welcome to episode one of Global Exchanges, a podcast about foreign exchange markets and related issues. I'm Greg Anderson. I will be joined by my co-host Stephen Gallo in this episode. Together we will discuss background issues and pertinent details regarding this week's virtual meeting of G20 Finance Ministers and Central Bankers. The title for this episode is G20 in a New Era in Search of Common Ground.

Stephen Gallo:

Hi, I'm Stephen Gallo, a London-based FX strategist. Welcome to Global Exchanges presented by BMO Capital Markets.

Greg Anderson:

Hi, I'm Greg Anderson, a New York-based FX strategist, I'm Stephen's cohost.

Stephen Gallo:

In each weekly podcasts like today's, we discuss our perspectives on the global economy and the foreign exchange market. We also bring in guests from the FX industry and from related financial markets like commodities.

Greg Anderson:

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Speaker 3:

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Greg Anderson:

Hi, Stephen. So here we are Tuesday, February 23rd. What are you looking at in your currencies, in your part of the world in London?

Stephen Gallo:

So definitely on the radar screen this week is the meeting of G20 Finance Ministers and Central Bank Officials. At the end of the week, they're going to be issuing their normal communique following that meeting, that will be of interest. And I also think the comments from Christine Lagarde regarding the rise in longer-term interest rates, the fact that the central bank was monitoring this closely, that too is an important factor that should be given attention by FX investors.

Greg Anderson:

I think also for the USD and the currencies that I cover, the G20 will be an important moment, and it will be very interesting to see how Yellen represents the US's has perspective at the G20. And then the other thing that is very topical here isthe spike in long-term bond yields, and what this means for related financial markets such as foreign exchange. So Stephen, the G20 is being chaired by Italy this year, isn't that right?

Stephen Gallo:

That's right, Greg. Italy is the chair of the G20 this year. So they'll be hosting the meeting. And that means that Italy is also the master editor for the communique, which will be released after the virtual meeting takes place later this week. In terms of the logistics, the Finance Minister of Italy and the central bank governor will be hosting the press conference that takes place after the virtual meeting on Friday. And that's going to take place at 5:15 PM local time. That's 11:15 AM EDT

Stephen Gallo:

On the subject of past G20 statements, it strikes me as interesting that the last time the G20 mentioned anything about currencies in the communique was February 2020. And even then the commitment was kind of vague, referencing past commitments to not competitively devalue currencies, which were made in, for example, 2018. My question to you is, do you think the language needs to be revamped? And what, from your perspective is Yellen, representing the US side, going to be pushing for at this particular G20?

Greg Anderson:

So, Stephen, I think you've hit on something important. It's been so long since the G20 communique went through full language on foreign exchange that I think that they need to do it again, even if it is a repeat of what they said in 2018. And I'm going to read to you what they said then, they said, "We recognize that excessive volatility or disorderly movements in exchange rates can have adverse implications for economic and financial stability. We will refrain from competitive devaluations and will not target our exchange rates for competitive purposes." I think they have to say it again, even if they say just that. In terms of other things that Yellen might push for, I think there are several. So first off, verbal intervention, the US has, previously going back to '90s and 2000s, often encouraged G7 communiques, basically refrain from verbal intervention. That might be something that Yellen would push for this time around.

Greg Anderson:

Secondarily, through the pandemic, the US's trade deficit has gotten substantially worse and trade surpluses in other parts of the world have gotten bigger. And I think the US might push for recognition of that fact and the fact that those imbalances might be destabilizing, it should be reduced over the medium term. So Stephen, that said, what do you think Europe and China might push for?

Stephen Gallo:

So in terms of the Europe and China angle, I think this is where a degree of awkwardness within the G20 becomes apparent, because trade surpluses are important for both the Chinese and the European economies. And we know that both central banks in question, the PBOC and the European Central Bank are pretty sensitive to moves in their currencies for different reasons. And over the past few months, in particular, the ECB expressed a strong desire for a slow or non-existent pace of euro appreciation. So I think the representatives of these jurisdictions at this G20 meeting are going to be pressing for relatively loose language when it comes to exchange rates and pretty much no discussion of global imbalances. That would be my angle. My question to you Greg, is what are the elements do you think that these officials can work together on?

Greg Anderson:

What can they all agree on? Well, nothing pulls everyone together into a big group hug like having a common external enemy. And in this case, I think G20 finance ministers do have a common enemy. And that common enemy is rising yields. We've had a big spike in five-year and longer-duration yields, I would say centered in the US over the last couple of months, and it is propagating. So what can they agree on? They can agree on that this is bad, and they would like it to stop.

Stephen Gallo:

Well, Greg, on that point about yields that you just made, going back to what Lagarde said yesterday regarding the fact that the ECB was monitoring the move in long-term yields closely, I think it's probably deliberate that that language was used specifically because those utterances are similar to what we've heard the central bank say in the past about exchange rates. So the takeaway here, I think, has to be that not only does the central bank want to limit the extent of euro appreciation, but it;salso looking to counter any impact that higher yields might have on the euro too. I guess I would toss it back to you basking, how do you think yields are impacting the USD right now?

Greg Anderson:

, It's interesting, US 10-year yields have been rising really since the beginning of August. We were about 60 basis points then, but we rose to 95 basis points at the end of the year. And throughout that entire period, the US Dollar Index declined rather steadily. So, it didn't seem that the rise in yields had an impact on the USD . Thus far in 2021, the story has been a little bit different. We broke through, one the figure on the 10-year yield, up to about 120 basis points, and the USD paused, equities continued to rally, it didn't seem like there was a clear transmission of the rate move to foreign exchange, but the USD did pause. In the move over the last few days, as 10-year yields have gone from, we'll call it, 120 to 135 basis points there seems to have been a bit more transmission to the USD but it's not straightforward if you're looking at the Dollar Index.

Greg Anderson:

And the reason why is the USD has rallied against emerging currencies. So an example would be on the USDMXN axis, we've seen a substantial move higher, but at same time the USDhas declined against ‘safe havens’. So, an example there, USDJPY has moved from, 106.00 down to 105.00. And at the end of the day, that the index movement is muddied, but there has been a clear decline in risk-sensitive currencies and a rally in ‘safe havens’. I guess, at this point, Stephen, I throw it back to you: EURUSD , is it a ‘safe’ haven or a risk-sensitive currency? And actually, here's my question, we're sitting at1.21.5, do you think we're more likely to see 1.23 the figure or 1.20 the figure over the next few weeks?

Stephen Gallo:

Good question, Greg. I think EURUSD is a difficult pair to trade right now. If anything, EURUSD is probably in a migration phase between a risk-on currency pair and something else, but what that's something else is we don't really know right now. Look, there's a confluence of factors which are involved here . On the one hand, you've got the flows picture for the EUR ... The trade balance picture for theUSD . On the other hand, you have the ECBs influence on the EUR, particularly what the ECB has doing on the issue of exchange rates, and more recently, what Lagarde has said about interest rates yesterday, and then at the same time, you have FX investors nervously watching US yields.

Stephen Gallo:

I could also site evidence for you in a number of non-USD-euro cross rates, where the EURhas been performing actually as a better funding currency than a currency which is positively correlated to risk appetite So, I think for the time being, we're going to be 120, 122, whereas you buy at 1.20 in EURUSD and you look to sell, rallies above 122, for the time being anyway. I guess the question I have for you then Greg, is what aboutUSDCAD? What do you think the near-term outlook holds for USDCAD?

Greg Anderson:

I feel like we have gotten to a spot where probably the exchange rate is stuck. So we have, what I would call is really firm support at 1.25 the figure, that I suspect will be difficult to break, but at the same time, the direction of flows I believe is pushing the pair lower. And certainly the influence of higher energy prices is helping push the pair lower. So I would give you, for the next several weeks, an outlook that we're likely to stay 1.25 to figure to 1.27. And if we got up towards the top end of that range, it would be an attractive selling point. Let me toss it back to you, Stephen, we've seen a range in USDCNH, 6.40 to 6.50 over the last few weeks. Which of those two figures do you think breaks next, 6.40 or 6.50?

Stephen Gallo:

I think, Greg, we're likely to see 6.50 next. In a sense, I hope we do because I think on a near-term basis, 6.50 will be a pretty good selling opportunity in USDCNH . Never forget the fact of course, that China is a very adept currency manager. The one reason I would hold off on selling USDCNH right here in front of 6.50 is because China had its big uptick in yields before the US. And right now, if you look at rates in general in China, they're generally treading water. So I think that the better opportunity for selling USDCNH will be up at 6.50 or just above 6.50. The rest of the Asian regional currency should move in alignment with USDCNH ultimately.

Greg Anderson:

And you know, Stephen, I look at the LATAM complex and I suspect that even though it's not the same region, we'll see USD/LATAMmove more or less in alignment with USDCNH .

Stephen Gallo:

Greg, that's a great point to end it on. I think we'll wrap it up there until our next podcast in two weeks time.

Greg Anderson:

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Stephen Gallo:

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