

## 2019 FX Outlook: Peak Dollar

The dollar rally is in its final stretch, the euro will see a V-shaped move and things will get worse for the pound before they get better. Here's a quick look at our FX forecasts for next year



### ⬇️ USD: Surviving the climb and hoping for a safe descent

We have published our [2019 FX Outlook](#), with the overriding theme being that a peak in the dollar is in sight. While we are not there just yet and should see another move higher in 1H19 (as the Fed continues tightening and dollar hedging costs remain high), we expect a bearish narrative to develop as 2019 progresses. US rates should come off their highs by the end of the year and as US growth converges lower vs the Rest of the World, we expect investors to rotate out of US asset markets. A search for alternative sources of stimulus may also see the White House favouring a weaker dollar which looks materially overvalued in trade-weighted terms, as well as on a bilateral basis. Based on our medium-term valuation models, only two currencies in the G10 and emerging markets (liquid) universe are not cheap against the US dollar (Swiss franc and Israeli shekel). The rest are undervalued and in many cases heavily undervalued. The cheap valuation should be one of the reasons why EM high yielders may not necessarily suffer excessively during the last leg of the US dollar bull cycle. We particularly like the Indonesian rupiah, which offers cheap valuation and high risk-adjusted carry.

## ⬆️ EUR: V-shape profile for 2019

For EUR/USD, we look for a V-shaped profile next year. We think the pair will decline to 1.10 by 1Q19, as Italian risk peaks and the US dollar moves higher in the final leg of the bull cycle, before rebounding to 1.20 by end-2019. This should be driven by a turn lower in the dollar and the European Central Bank's first depo hike in late-2019. This should give modest support to a cheap euro. But is it fair to say that the euro and EUR/USD won't deliver any real fireworks next year (particularly when compared to the 2017 price action) as the window for the independent euro rally is closing and the ECB will just about bring the depo rate to zero (but not above). Hence, our constructive EUR/USD outlook for 2H19 is more about a negative US dollar view than a bullish euro call.

## ⬇️ GBP: Things will get worse before getting better

For the British pound, we think that things will get worse (ie EUR/GBP above 0.90) before getting better. But the eventual UK parliamentary approval of the Withdrawal Agreement (which may not be seen until February) should translate into a one-off GBP rally, with EUR/GBP approaching 0.85 in April next year. Expect GBP to continue to trade on volatility levels more common in emerging markets. We fully recognise the low predictability of GBP short-term moves and that's why we only trade GBP via option structures with clearly defined downside.

## ➡️ CEE FX: No longer negative on HUF, not convinced about large CZK gains

In the central and eastern Europe FX space, we think the worst for the Hungarian forint is over with the National Bank of Hungary taking a more cautious stance. We strongly believe that any further gains in the Czech koruna are to be heavily reliant on the central bank's goodwill (rather than EUR/USD or general risk appetite). Given the shape of the forward curve, shorting the Romanian leu is a futile battle. We also consider CEE FX relative value hedges against the non-negligible risk of the US imposing auto tariffs on the EU.