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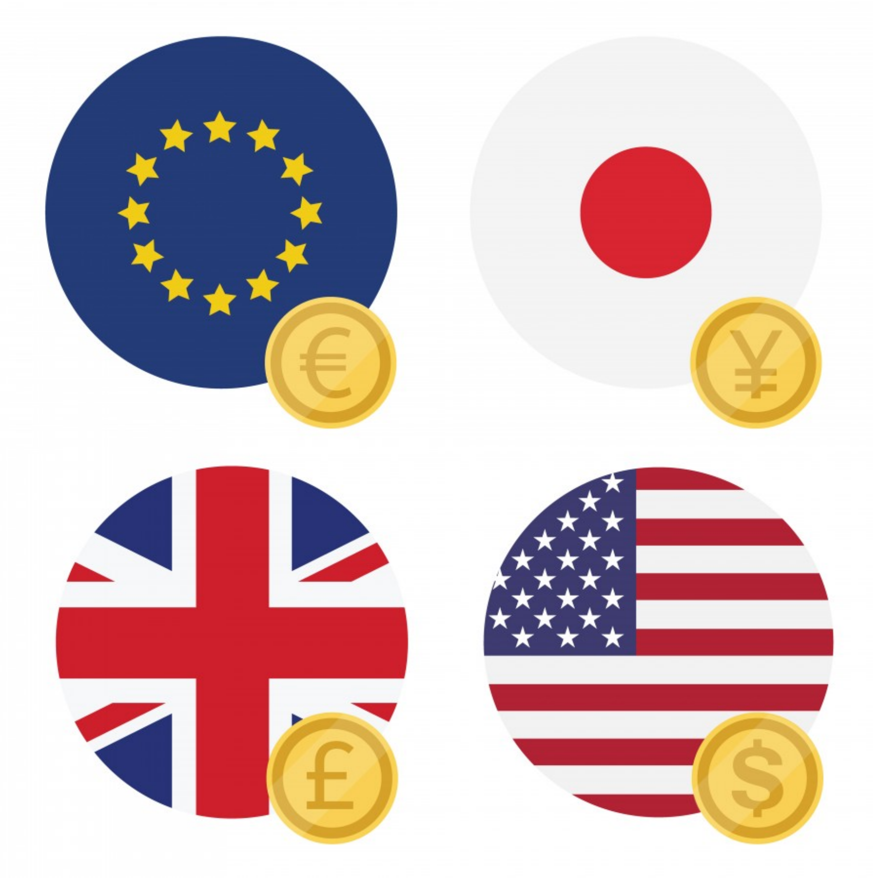
At a glance guide to FX in 2018

As part of our 2018 FX outlook, 'Happy Hour', here's a guide to where we think major currency pairs could be heading



Our overall thinking

Optimism reigns! In contrast to fears at the start of the year, policy uncertainty has actually fallen. This and signs of co-ordinated growth have sent consumer and business confidence to post-Global Financial Crisis highs. Pro-growth FX is starting to perform well. We are less worried than some by the removal of central bank liquidity. Instead, we believe the conversion of business confidence into stronger investment will be the key story for FX markets in 2018. European and Asian FX score highly here.

But this 'Happy Hour' by definition cannot be extended indefinitely. Stiffer headwinds may emerge towards the end of 2018 and greater weight may be given to FX backed by external surpluses. We believe the dollar softens under most scenarios.

Below see our summary of major currency pairs. And take a look at our overall FX thoughts here:

The dollar, the euro, the pound and the Scandies

We look for EUR/USD to trade to 1.30 in 2018. The EUR is in the 'sweet spot' of this global recovery and looks well-positioned for the investment cycle. Strong Eurozone growth (potentially 2.5%) focuses attention on ECB normalisation. Eurozone's 3% current account surplus also protects the still-undervalued EUR during risk-off episodes.

The dollar's best chance of a rally may be in 1Q18 when 10-year US Treasury yields advance to 2.60/2.70%. **That could push USD/JPY to 115**. However, recovering growth stories elsewhere in the world should extend the dollar's benign decline later in 2018. Coincidentally, the dollar also usually suffers in the second year of Republican presidencies.

We look for **GBP to be one of the primary beneficiaries of reduced policy uncertainty** – at least in the early part of 2018. Approval to proceed to Phase II of Brexit should prompt a brief re-rating of the UK economic cycle and **send GBP/USD to 1.40.**

The Scandies have confounded the market in the final quarter of 2017. We look for a technical SEK rally in 1Q18 as local money market rates increase – **taking EUR/SEK to 9.60** – but look for stability thereafter. **Only undervaluation supports NOK in 2018.**

$-bloc, CE3 and EMEA high-yielders

Dollar bloc FX will be the relative underperformers of 2018. Within the space, **CAD** is set to gently rally amid a BoC hiking cycle. Depleting yield advantage will keep **AUD** and **NZD** sidelined – with the latter to bounce back first in 2Q18 on an RBNZ tightening story.

CE3 currencies should continue to perform strongly. Of the pack, we continue to favour the **CZK**. Gains should be driven by a central bank genuinely concerned by capacity pressures and in the midst of a tightening cycle. **CE3 currencies also benefit from the investment cycle** and the exposure to the strengthening Eurozone recovery.

EMEA high yielders will continue to face challenges in 2018. Both the **TRY and ZAR** are very cheap, but to recover will require resolution of political challenges as well as appropriate policy responses – be they fiscal for South Africa or monetary for Turkey. **The RUB should prove a relative outperformer** buoyed by yield and lower volatility.

Latam and China

Latam FX in 2018 will once again be determined by the political calendar and the relative performance of commodities pertinent to local producers. **MXN** will struggle ahead of elections in July and perhaps a NAFTA stand-off too. **USD/MXN could trade to 20.50 next summer**.

October elections should also keep **BRL** in check. The Chilean peso looks to be the region's outperformer, given the expected deficit in the copper market.

The **Renminbi should enjoy modest gains** against a slightly softer dollar, with the PBOC now having the market under greater control. KRW looks well positioned to benefit from the global industrial cycle and the start of a tightening cycle. **USD/KRW to 1000.** We also like the recovery story in Malaysia. Philippine Peso to underperform.

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