

Counting the cost of chip wars

Despite a temporary reprieve to US companies doing business with Huawei, markets are still bracing for a further escalation in the trade conflict



⬆️ USD: Divergence story and dollar strength continues

News that President Trump has granted a temporary, three month reprieve to US companies doing business with Huawei looks more a matter of self-interest than a negotiating tactic with China. The Philadelphia Semiconductor index was off 4% yesterday, while alternative handset and network equipment suppliers such as Samsung, Nokia and Ericsson all rallied. Our point here is that this temporary grace period doesn't look like an entreaty to China and until we hear otherwise, the markets will be bracing for further retaliation from China and further escalation from the US. Elsewhere, the macro fallout from the trade war largely lands outside of US shores, with the Reserve Bank of Australia pointing strongly overnight to a rate cut in June (following New Zealand's move earlier this month). Expect the dollar to hold onto this year's strength until we see clear signs of a US slowdown (none so far) or the Federal Reserve threatens to do something about low inflation. On that subject look out for a speech from Chicago Fed's Charles Evans at 1645CET today. DXY to challenge the year's high at 98.33.

⬇️ EUR: More downward revisions from the OECD

The OECD releases its first forecasts of the year today. Following the lead of the European Central

Bank and the European Commission, we should expect some hefty downward revisions to eurozone growth forecasts from the 1.8% (2019) and 1.6% (2020) the OECD had forecast last November. Revisions to 1.2% and 1.5%, respectively were recently made by the EC. We'll also see eurozone consumer confidence for May. US consumer confidence is pushing to a cycle high and any further deterioration in the eurozone equivalent will merely serve to support the macro divergence story. A market bracing for the fallout of Thursday's European elections (results Sunday) suggests EUR/USD upside will be limited (1.1180/1200) before a stronger test of support at 1.1110/30. We still like a lower EUR/JPY, given the risk that trade retaliation could easily unnerve global equity markets again.

⬇ GBP: Fourth time unlucky

Brexit focus today turns to Prime Minister Theresa May briefing the cabinet on changes she's proposing to the withdrawal deal such that it could make it through parliament in two weeks' time. There seems little interest in the Cabinet to make this work and instead, positioning for the leadership challenge dominates. Cable should trade down to 1.2660/70, while EUR/GBP looks more mixed in a 0.8750-0.8800 range.

⬇ HUF: EUR/HUF en route to 330

Pressure on EUR/USD normally leads to underperformance of CE4 FX and that certainly is the case right now. Very negative real rates and evaporating support from the current account leaves the Hungarian forint vulnerable and EUR/HUF en route to 330.

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