

Daily FX Strategy: Race to the bottom

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Source: Shutterstock

📉 USD: It will be tough for the Fed to hold the line, dollar could ease

Caught in the middle of the US-China trade war, New Zealand's Reserve Bank of New Zealand surprised last night with a 50 basis point rate cut. The policy rate is now at a record low of 1.00% and the market prices another 50bp within the next three months. It seems the RBNZ feels the need to get to the lower bound as quickly as possible. That will encourage thoughts that other central banks, such as the ECB, will not hang around when they next meet.

Back to the China story, today's USD/CNY fixing at 6.9996 suggests the People's Bank of China is happy to see the market set the renminbi's rate and a fixing above 7.00 can only be a matter of time. [As we noted recently](#), the risk of a CNY devaluation can be added to the list of investors' fears and stock-watchers will be fearful that Monday's upside gap in the S&P 500 to 2914 does not get filled before heavier losses ensue. With commodity markets under pressure and the 2-10 US year yield curve at the flattest of the year, the risk is that the Fed gets bulldozed by the market and has to cave in to accelerated easing. Let's see what Chicago Fed's Charles Evans has to say at 1530CET

today. We suspect the Fed will have to turn more dovish and continue to favour a lower USD/JPY and USD/CHF, both to threaten big levels at 105.00 and 0.9700.

➔ EUR: Another poor IP reading in Germany

German June IP has just been released at -5.2% YoY – the worst since 2009. This will also add weight to the view that the ECB has to be more aggressive. Additionally the ECB will be looking at the trade weighted euro which has appreciated 2% since mid-July on the back of weakness in the yuan and sterling – which have large 23% and 12% weights in the euro's TWI. We think the narrowing in short-dated EUR-USD swap spreads is keeping EUR/USD supported (spreads are 120bp narrower from last November) as is the unquantifiable threat of White House intervention on the dollar. EUR/USD to trade within the confines of a 1.1110 to 1.1260 range, while EUR/JPY and EUR/CHF should head back to their lows of 117.70 & 1.0860.

⬇ GBP: It's come to this – Brexit with no government

The Brexit debate has moved on to focusing on whether a potential lost no-confidence vote in the Johnson government in October could still see Number 10 push through Brexit. A hard Brexit without a functioning government is a particularly unattractive prospect for the pound and brings forward our [3Q19 scenario](#) which would set EUR/GBP at 0.95 and cable at 1.18.

⬆ JPY: Volatility is on the rise

We are seeing a significant rise in realised volatility (e.g. one week USD/JPY now over 10% and one month close to 7%). This will hurt high yield/carry trade strategies and should keep the Japanese yen in demand across the board. Long Mexican peso/Japanese yen had been a good carry trade through 1H19, we see the exact opposite now with a market heavily long MXN subject to de-leveraging risks. MXN/JPY risks 5.15.

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