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Article

Dollar softens despite market's trade truce rethink

Investors appear to be doubting the durability of the US-China trade war truce but the dollar softness continues

Contents

- USD: Soft dollar despite the fading risk rally
- EUR: Modest upside but no fireworks
- GBP: Few reasons to be cheerful
- CZK: Solid wage growth to matter more for interest rate expectations than FX

USD: Soft dollar despite the fading risk rally

While the equity rally stalled as the market appears to be doubting the durability of the US-China trade war truce (the 90-day window is simply too short to resolve the key issues) the dollar softness continues, with USD down against G10 currencies (bar the British pound) overnight as well as against most Asian emerging market FX. As per our 2019 FX Outlook: Peak Dollar, most G10 and EM currencies (except the Swiss franc and Israeli shekel) screen as undervalued vs the USD. This raises the bar for further USD strength in the absence of an escalating trade war or more hawkish Federal Reserve. For oil prices, we look for another move higher in response to the OPEC meeting outcome this week, in turn benefiting the likes of the rouble and Mexican peso in the EM space, and Norwegian krone and Canadian dollar in the G10 space (see FX: Key beneficiaries of the relief rally).

EUR: Modest upside but no fireworks

EUR/USD remains gently supported and about to re-test the 1.1400 level, reflecting modest US dollar weakness rather than euro strength. We think similar dynamics will determine the euro's price action next year, with any longer lasting (yet very gradual) EUR/USD upside towards 1.20 being driven by the peak in the USD bull cycle rather than meaningful EUR strength (as seen in 2017). This is because the euro is running out of domestic catalysts for meaningful upside (i.e. no hawkish ECB tightening expected). As a result, we believe the positive spillover into the EUR/USD-correlated central and eastern Europe FX will be more muted next year vs the 2017 rally (also due in part to the fact that CEE economies are no longer booming vs strong growth in 2017 - see FX Outlook).

GBP: Few reasons to be cheerful

Bank of England Governor Mark Carney speaks in Parliament today. The main focus will be on what a 'no deal' Brexit means for the economy. We expect the core BoE message to remain relatively upbeat, reiterating the view that, under the assumption of no hard Brexit, the BoE will be preparing for rate hikes. Today is also the first day of the Parliamentary debate on the Withdrawal Agreement, which should reiterate the divisions between and within the political parties, pointing to a low likelihood of the Brexit deal being voted through Parliament next week. Expect GBP to remain under pressure, with EUR/GBP converging to 0.9000.

CZK: Solid wage growth to matter more for interest rate expectations than FX

Czech 3Q18 real wage growth should remain strong at 5.5% year-on-year. The modest deceleration from the previous quarter's growth of 6.2% YoY is largely attributable to the base effect related to increasing public wages a year ago. While this should continue to point to more central bank hikes next year, we expect the impact on the Czech koruna to be limited as the currency remains overbought and is likely to weaken into the year-end, in line with seasonal patterns, with EUR/CZK still to re-test the 26.00 level this month.

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