

EM FX: Floating in a sea of red

Given the Chinese yuan's increasing sphere of FX influence, not just Asian FX but increasingly commodity FX as well, further renminbi weakness stands to drag many currencies with it



📈 USD: Dollar enjoying safe haven characteristics

Away from the jubilation of Liverpool FC supporters is a less friendly sea of red that is global equity markets. Here, confidence that the US and China would reach a trade deal has taken a knock (although JP Morgan's Jamie Dimon thinks the odds of a deal are 80%) and USD/CNY has also slipped anchor. Given the CNY's increasing sphere of FX influence (not just Asian FX but increasingly commodity FX as well), further renminbi weakness stands to drag many currencies with it. We note that the offshore CNH performed poorly late yesterday and unless some positive news emerges today, USD/CNH could trade out to the 6.81 area, matching the 400 pip wide in spreads to the onshore USD/CNY seen over the last year. Elsewhere, the New Zealand dollar stays soft after the central bank cut rates to 1.50% in response to 'emerging headwinds'. Here, the RBNZ cut growth forecasts for major trading partners by up to 0.4% and inserted another cut into their forecast profile. Overall, defensive positions look advisable and the lack of correlation with the CNY is a distinct advantage for the Japanese yen. If safety, liquidity & return are the guiding principles for the world's FX reserve managers, they should be good enough for the private sector too. The US dollar ticks all three boxes here.

⬇ EUR: Exposed to China's downside

Renewed US-China trade tensions aren't helping the euro and merely cementing the view that European Central Bank rates will stay lower for longer. Two year EUR swap rates are currently near the deposit rate floor at -0.40% and five year rates (now -0.16%) look like they can break down to cycle lows as well. The EUR has a decent positive correlation with the CNY (through trade presumably) and unless President Trump amps up his criticism of the Federal Reserve (and the strong dollar), we'd expect EUR/USD to stay offered in a 1.1150-1.1250 range.

⬇ GBP: Participation in European elections kicks the can down the road

The announcement that the UK will take part in European elections at the end of May confirms that cross-party Brexit talks are going nowhere fast. This also refocuses attention on a leadership challenge to Prime Minister Theresa May. Favour cable to 1.2950.

⬇ ZAR: South Africa goes to the polls

South Africa holds general elections today. As our sovereign credit strategist Trieu Pham writes, investors are looking for the positives here – looking for a handsome win for Cyril Ramaphosa's ANC with 60%+ support, such that reforms can be delivered. Some polls, however, suggest support is a more perilous 50%. The international backdrop to the South African rand is vulnerable right now, such that any disappointment in the election could send USD/ZAR to 14.75/15.00.

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