FX: European re-rating?

Investors were very pessimistic on Europe at the start of the year (and underweight European assets) but there's a case to be made for a modest re-rating of European FX if trade trends calm, China stabilises and clarity emerges on Brexit

Source: Shutterstock

USD: A rebound in January industrial production will be welcome

We are starting to see activity currencies in the G10 space perform a little better and there's a case to be made that this trend continues. China and Europe had been the two key areas of concern at the start of 2019 and even though there is still much uncertainty, targeted fiscal stimulus in China (VAT cut 1 April) and some potential clarity emerging on Brexit over coming weeks could improve sentiment - particularly in the traded goods space. This is occurring against a backdrop of exceptionally low cross asset market volatility, where low interest rate volatility in particular (both the Bank of Japan and the European Central Bank are operating off long forward guidance on low rates) is weighing heavily on FX volatility. Today's release of US industrial production for January may support this slightly more optimistic view of the world. We continue to favour: (i) the US dollar staying bid against the Japanese yen, (ii) high yield in general, but (iii) are wary of a modest positive re-rating in European FX. Expect DXY to remain trapped in a 96-97 range.

EUR: The coming clarity on Brexit may help

EUR/USD has been supported by GBP and we see that trend continuing in the near term. As above, investors were very pessimistic on Europe at the start of the year (and underweight European assets) and there's a case to be made for a modest re-rating of European FX if trade trends calm, China can support its domestic economy and clarity emerges on Brexit. In a week's time we'll see the March PMI releases for the eurozone, which could show some more stability – e.g. will the manufacturing PMI follow services higher? Negative rates in the eurozone don't make EUR/USD an attractive proposition for the time being, but it can probably still limp towards the 1.1370/1400 area. Elsewhere, finally a sensible move in FX markets! EUR/NOK has broken below 9.70, buoyed by high oil prices and the prospect of a Norges Bank rate hike next Wednesday. We favour 9.65 in the short term and 9.50 this summer. The same can be said of the Hungarian forint, where it seems all systems are go for the National Bank of Hungary to start its normalisation process on 26 March. EUR/HUF could see 312.80/313.00.

GBP: Clarity to emerge next week

Dare we say there are two key paths for Brexit next week? 1) Brexiteers panic and choose to back May's withdrawal agreement, 2) her deal is rejected again and indicative votes start to build a coalition around a softer Brexit. Both paths look supportive for sterling, thus we expect GBP/USD to meet buyers below 1.32.

JPY: BoJ to keep USD/JPY supported

No real changes were seen at the latest Bank of Japan rate meeting. And they will have to deal with a consumption tax hike in October. 112.20 is our short term USD/JPY target.

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