Fed's waiting game unnerves the dollar

The dollar has come under pressure and could move lower still, but expect this weakness versus the euro and yen to be short-lived

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USD: FOMC minutes spell out the Fed's position

The dollar has come under broad-based pressure, hit by: (i) clear signals of a pause in tightening from the Fed and (ii) no signs of a breakthrough in the US government shutdown. On the former, the minutes of the December FOMC meeting spelt out clearly that: (i) the insertion of the verb 'judges' into the statement was designed to usher in a more data dependent approach to policy and (ii) the insertion of 'some' additional tightening served to show the limited nature of further rate hikes. The market will now increasingly debate whether the Fed abandons forward guidance altogether in favour of a more data dependent approach – i.e. drops the mention of additional tightening. The US government shutdown isn't helping the dollar either, muddying the data and adding to fears of the typical 1Q soft patch in US GDP. The Fed pause has ushered in a period of position adjustment in the dollar (including against the low yielders) and it's hard to stand in the way of it right now. The Fed pause is good news however to the emerging market high yielders battered by dollar strength and high US rates last year and as long as the government shutdown does not prompt a major bout of US equity selling, we're cautiously positive on the risk environment. Today the market will focus on a speech from Fed Chair Jerome Powell at 18CET – though the Fed position looks reasonably clear now. The US dollar index could correct a little lower, but expect USD weakness versus EUR & JPY to be short-lived.

EUR: Short squeeze dominates

Clear signs of patience from the Fed are leaving long dollar positions vulnerable across the board – including against the EUR. Speculative EUR shorts on CME futures were at reasonably extended levels in the last Commitment of Traders report and had been built anywhere between the 1.18 and 1.13 area. More of those positions are increasingly underwater and whilst the macro story may not favour a higher EUR – it's hard to stand in the way of a short squeeze. We haven't been calling for it, but this short squeeze now risks extending to 1.1620 and perhaps higher if things get out of hand.

GBP: May creates a cross-party coalition – but it's against her

Unfortunately for Prime Minister Theresa May, she's created a cross-party coalition on Brexit - but it's a coalition against her and ties her hands against a no-deal policy path. The next five to six weeks look to be a tumultuous period for GBP and it looks too early to be marketing the story that GBP rallies on the chances of a second referendum.

CNY: Russia increases CNY share in its FX reserves to 15%!

Success! The Renminbi now represents a 15% share in Russia's FX reserves. This owes a lot to Russia disentangling itself from the US financial system, but does show Chinese asset markets have the liquidity to accommodate FX reserve managers. It's also a reminder of the new Sino-Russia axis post Trump.

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