FX: A day for geopolitics

US equities have retraced 80% of last year's sell-off. Does that leave the market vulnerable to poor geopolitical news?

USD: Trump meets Kim Jong Un, Cohen testifies, India-Pakistan tensions flare

Benign conditions have seen US equities retrace 80% of last year's sell-off, perhaps leaving them a little vulnerable now to any poor geopolitical news. Critics would argue that President Trump has timed today's meeting with Kim Jong Un to push headlines from today's testimony from Michael Cohen off the front pages. While that testimony will be scrutinised, the fact that Cohen has already been convicted for lying to Congress should limit its impact on financial markets. Equities could also be worried about Congress starting to fight back against Trump's use of emergency powers to fund the wall – but again that doesn't seem a strong enough reason to dump equities. And unless there is a sharp escalation in India-Pakistan tensions, we suspect this year's equity rally can look through these geopolitical challenges. For today, look out for Fed Chair Jay Powell's second day of testimony, trade data and 16CET testimony from US Trade Representative Robert Lighthizer on US-China trade relations. There are risks, but favour DXY trading 96-97 amidst lower volatility.

EUR: Signs of stability?

Following last week's slightly better services confidence data, let's see whether the eurozone business climate indicator can slow its descent in Feb. EUR/USD has been helped by sterling, but will struggle to pierce 1.1400/25. Bundesbank President Jens Weidmann speaks 11CET.

GBP: Is all the good news priced in?

There's certainly a lot of momentum behind sterling at the moment. Yesterday we had felt that GBP gains could hold in to today ahead of what should have been a Cooper-Letwin amendment – designed for parliament to take control of the Brexit process and avoid a no-deal. But it seems that Prime Minister Theresa May's offer of a No-Deal or Short Delay vote on 13 March has taken the wind out of the amendment's sails. Thus it's not clear if GBP needs to get a further boost today? True, the market is still short GBP, but those short positions have been halved since last September. There is therefore a chance that 1.3300 does prove a top for cable.

CAD: Core inflation should keep markets guessing over a 2019 BoC hike

As has been the case overseas, the market has substantially re-priced the Bank of Canada's tightening cycle and now prices it flat for three years (having priced 55 basis points of 2019 rate hikes back in November). What's the next move? We doubt the BoC will want to get too hawkish while the Fed is in wait-and-see mode, but today's January CPI data could remind the market that the central bank is looking for opportunities to hike. After the surprise rise in December's headline CPI to 2.0% year-on-year, energy prices should see the headline rate drop to 1.4-1.6% YoY – yet core should stay near the BoC's 2% target. The Canasian dollar could also get some help from oil prices, if today's EIA weekly crude inventory sees the first drop in six weeks (API data showed a 4.2 million draw yesterday). Assuming geopolitical risks don't hit equities, favour USD/CAD to 1.3100/10.

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