FX Daily: Back on track

At look at how major currency pairs could perform this Friday

USD: More dollar weakness ahead

We're arguing that 2021 will the year the FX market gets back on track after years of diversions from President Trump's protectionism policies and the Covid-19 crisis. We're forecasting a broad-based dollar weakness, by 5-10% against most currencies. There are two things central to that bearish dollar call. First, that policymakers provide sufficient fiscal and monetary policy support such that inflation expectations rise. Second, the Fed keeps policy rates on the floor such that US real interest rates stay very negative.

This very loose US monetary setting, plus a reversal of the White House's protectionist policies, should allow currencies in the Rest of the World to breathe again. We are bullish on EUR/USD targeting 1.25 – largely due to weak USD characteristics, rather than due to projected strong EUR dynamics. This should allow European FX to flourish vs the dollar – NOK and SEK in the G10 space and CZK in the CEE space in particular. The return back on track characterised by reduced volatility and behind the curve Fed should favour carry such as TRY and RUB. We also believe that with Chinese authorities embracing a stronger CNY since July, the market liberalisation measures should allow USD/CNY to reach 6.30 next year. Overall, USD is to further fade in 2021

EUR: Investors eye the December EU Summit as the resolution point.

Despite no progress made on the issue of the EU budget, the Recovery fund and the rule of a law clause in the virtual call of EU leaders yesterday, the effect on EUR has been limited as such an outcome did not come as a surprise. Investors eye the December EU Summit as the resolution point. We are inclined to think a common solution will be eventually found (in line with the prior examples of EU disputes) taking away the hurdle for more EUR/USD upside in 2021 during the wider soft USD environment.

GBP: Scope for upside, but a limited upside vs the euro

EUR/GBP continues to tread water given no material announcement on the UK-EU trade negotiations. After the initial one-off positive adjustment to GBP in response to the deal, we expect EUR/GBP to plateau around 0.88 in 2021 given (a) the uninspiring UK economic prospects; (b) no normalisation from the Bank of England; (c) no material EUR/GBP mis-valuation. Given our bullish EUR/USD, we prefer GBP/USD

TRY: Brighter days ahead

The Central Bank of Turkey delivered yesterday and hiked the repo rate by 475bp. We think the shift in the CBT stance towards the tighter policy (which in our view is to stay for months ahead) should bring back stability and lead to further lira gains as its risk premium gets compressed further. The currency now benefits from superior nominal and real rates, while the improving current account position envisaged for 2021 should also help. We expect USD/TRY to dip to 7.20.

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com