

FX Daily: Proportionate response

Markets are optimistic that Middle East tensions won't escalate further after Iran's foreign minister said Iran has "concluded" its "proportionate" response to the targeted killing of Qassem Solleimani last week. We're not so sure this is the end of it



➔ USD: Markets await Trump's statement Wednesday morning

Markets have reacted in sanguine fashion to events overnight in Iraq. In our FX space, USD/JPY has completely retraced the losses seen in early Asia, when news of the missile attacks broke. The market seems to be taking at face value the words from Iran's foreign minister that 'Iran took and concluded proportionate measures'. We doubt the word 'concluded' really draws a line under the targeted killing of Qassem Solleimani last week, but for the time being the market seems to be trading like there will be no further escalation. Let's see what President Trump has to say when he makes a statement, we're guessing around 13/14CET. Since the start of the year, FX markets have been behaving in an orderly fashion, where safe haven/oil exporters are outperforming the oil importers and those currencies more correlated with risk. The Fed expectations curve has been re-priced some 15 basis points lower since the start of the year (largely in the one-year area), although conversely the pass-through of higher oil prices into inflation is twice as powerful in the US as it is in Germany. Gold may be telling us that the dollar should be embarking on a broader bear trend, but decent US growth and difficult risk environment for the short term tends should favour USD strength versus the high yielders and weakness versus safe havens.

➔ EUR: Industrial slump continues

The latest news out of Germany shows another large fall in factory goods orders in November and serves as a reminder of the inventory-to-sales build up, which may leave the German industrial sector stagnant through the first half. EUR/USD has been very quiet during this period of Middle East tension and there seems little appetite to take it out of a 1.1130-1.1230 range. Elsewhere in Europe, Poland saw [very high inflation in December](#) and the MPC meets today. CPI could reach 4.5% in the first quarter, but the Polish MPC (similar to Hungary) seems happy to look through the spike. Let's see whether bond investors remain happy, too.

➔ GBP: Von Der Leyen in London

Sterling's highlight today may be new European Commission President Ursula von der Leyen's trip to London. She meets Prime Minister Boris Johnson and at 1215CET delivers a speech on the future of the EU-UK partnership to the London School of Economics. A cordial set of meetings might be greeted positively by the pound. EUR/GBP could edge to the lower end of 0.84-0.86 range.

⬆ CHF: SNB may has its hands full

EUR/CHF is pressing cycle lows at 1.0800 and the Swiss National Bank may be more inclined to intervene than usual since USD/CHF is offered too. Failure to hold the 1.0800 area could see EUR/CHF drop to 1.0635/50, as investors add the Swiss franc to portfolios.

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