

FX: Dodging bullets

The formal delay in the imposition of extra tariffs on China and what should be more dovish comments from the Federal Reserve should be positive for risk assets this week



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➔ USD: Asset markets could enjoy some better news on trade and a dovish Fed

While the mood music on US-China trade relations has been better this year (and thus potentially priced in), the delay in imposing additional tariffs should be welcomed and the benefits spread beyond the borders of Chinese asset markets into the commodities sector and also to those open economies hit by the trade war, including Europe. A potentially encouraging week for risk should also be supported by semi-annual testimony from Fed Chair Jerome Powell on Tuesday and Wednesday. Last week's release of January's FOMC minutes makes the patient approach reasonably clear and the likelihood that the Fed will stop quantitative tightening (shrinking its balance sheet) in 2H19. We'll also see the shutdown-delayed 4Q US GDP data on Thursday (expected at a healthy 2.4% quarter-on-quarter annualised) and January personal income plus the February manufacturing ISM on Friday. The wild card this week will be congressional testimony from President Trump's former lawyer, Michael Cohen, on Wednesday. Given that US money markets now price in easier policy over the next 18 months, a better risk environment could see US rates edge a little higher, high yield FX performing well and USD/JPY staying near 111.00. DXY

could edge to 96 if Europe FX gets a modest bounce.

⬆️ EUR: Italy avoids a downgrade

Fitch chose not to downgrade Italy's sovereign rating on Friday (but did upgrade Hungary). The better news on US-China relations could add to some optimism for European FX, although we doubt EUR/USD needs to rally too far – 1.1400 may be enough. The ECB seems to be playing coy about the need to announce fresh targeted long-term refinancing operations (TLTROs) at next week's European Central Bank meeting, but the soft confidence data (including Friday's German IFO) suggests the ECB will still be worried and an extension in the forward guidance for low rates is possible. The Hungarian upgrade has been welcomed by the Hungarian forint. If the threat of auto tariffs can remain in abeyance (US Trade Representative Robert Lighthizer testifies on trade this Wednesday), long HUF positions on expectations of central bank normalisation can remain intact.

⬇️ GBP: Delaying the inevitable

Parliament won't now get a meaningful vote on Brexit until 12 March, just 17 days before Brexit. There is a chance sterling gets excited about an amendment (Cooper-Letwin) on Wednesday, giving parliament a say in an Article 50 delay, but this seems clutching at straws. Favour EUR/GBP edging to 0.8750.

➡️ IDR: Outperforming the steep forward curve

Some apparent progress on US-China trade relations and what should be a constructive risk environment should see high yield FX outperform steep forward curves. If Chinese yuan stability is agreed, then long Indonesian rupiah positions could perform.

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