FX: Don't stop believing

What a US shutdown means for the dollar, why there's more upside for the pound this year and why politics and the ECB could keep the euro in check

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USD: Government shutdown noise to keep dollar soft... but any big fallout unlikely

The odds of a US government shutdown have risen sharply in the past 24 hours as it looks highly likely that the Senate will not be able to muster the 60 votes that are required to pass the short-term spending bill. While we would expect such noise to keep the dollar on the back foot, any fundamental fallout at this stage would seem premature – not least as history tends to show that some sort of conciliatory approach to keep the government functioning in the long-run will ultimately prevail within Congress. Look for DXY to be supported above 90.00.

EUR: ECB and German political event risks may keep upside in check for now

While the looming spectre of next week's ECB meeting may keep EUR upside in check, we note that this weekend also sees a key moment for German politics; the Social Democratic Party will vote on whether to begin formal coalition talks with Chancellor Merkel. The event risk may see

EUR/$ stabilise in the 1.2200/50 region today – notwithstanding any (shutdown-related) further $ weakness.

GBP: In search of a positive catalyst to keep markets believing in more upside

The pound is within touching distance of our long-held conviction call of 1.40 against the US dollar in 1Q18 – but even we're slightly surprised by the speed at which we have got there. Sure, most of it has to do with extensive dollar weakness – which has evolved pretty much in line with our thinking. But one can also detect a subtle shift in the directional sentiment for GBP – not least as the doomsday Brexit tail risks gradually fade (for good reasons, they will never fully disappear).

We do think there is more upside for GBP yet to come in 2018 – but for now, we will require a positive GBP-related catalyst to take us over the 1.40 line. Here we continue to cite two non-mutually exclusive potential sources: (1) positive UK data surprises and (2) actual Brexit progress in the form of an agreed transition deal. Today's UK retail sales figures will be noisy due to the distortive 'Black Friday' effects – so any fallout for GBP from a weak headline print may be short-lived. While resilience in the UK consumer is important – it is the investment side of the economy that has the greater scope to positively surprise to the upside in 2018 (via the theoretical lens of reduced uncertainty). We look for GBP/USD to consolidate within the 1.3850-1.3900 area – with outside risks of 1.40 today.

AUD: Upside limited as US steel tariff risks add to bearish iron ore dynamics

Despite a healthy Australian jobs report, positive Chinese GDP surprise and soft US dollar environment – AUD/USD has failed to make much headway above the 0.80 level. We're not overly surprised given that investors are likely to view this as the Reserve Bank of Australia's threshold for increased currency jawboning – especially while local inflation remains benign (4Q CPI data due 31 Jan). Equally, a channel of recent AUD support – rising iron ore prices – looks set to revert; our commodities team sees the rally up to US$75/t as overdone now and expect a return to US$55/t by 2Q18. An added headwind is the spectre of US steel tariffs – President Trump has now received the Commerce Department's Section 232 report and has 90 days to decide on recommended policy actions (the aluminium report will be released on Monday). Given that this could, in theory, occur anytime, the unpredictability may act as a limiting factor for AUD/USD in the near-term (1M target: 0.78).