

## FX: Going with the cyclical flow

The cyclical slowdown continues to drive global FX trends. Unless we see some material improvement in trade relations, expect pro-cyclical currencies, including the euro, staying under pressure. Barring a much more aggressive Fed easing cycle, we fear EUR/USD could drop into a new 1.05-1.10 trading range into year-end.



Source: Shutterstock

### FX dragged by global growth worries...

FX markets are very much trading in line with the global fears of secular stagnation. Those currencies most exposed to the global trade and manufacturing cycle are under-performing, while the counter-cyclical JPY and CHF continue to do well. Unless we witness a sea-change in trade relations or policy makers undertake sizeable stimulus, it looks like these trends will extend into year-end. This could mean EUR/USD starts to trade a 1.05-1.10 rather than 1.10-1.15 range.

When looking more broadly, the trade-weighted dollar is pressing the 2002 highs. So far President Trump has said that he can 'work with' the strong dollar, although he does remain sensitive to big figure breaks in key trading partners' currencies – e.g. USD/CNY trading through 7.00 and EUR/USD trading sub 1.10. However, his mechanism to reverse dollar strength still seems to be pressuring the Fed rather than FX intervention.

## ... and current trends are unlikely to reverse

Current trends look unlikely to reverse until we see a change in: a) trade relations or b) massive enough stimulus to steepen yield curves and weaken the dollar. On the former, we tentatively expect US-China trade relations to improve in 1Q/2Q 2020 (the low-point in the US activity cycle) and look for a rebound in pro-cyclical currencies early next year.

Alternatively, a turn in the dollar could come if the Fed were to act aggressively. That seems a tall order given that the market already prices 125bp of easing by end 2020. Of course, if the Fed were to cut 50bp on 18th September, suggesting a front-loaded easing cycle, that could put a stronger lid on the dollar. That seems unlikely at this stage. Instead it seems USD hedging costs (now 2.7% p.a for Europeans) will remain high for some time. In fact, we think US policy rates need to drop 50-75bp before rate spreads start to have a meaningful impact on the dollar.

Fig 10 FX performance against the dollar since 1<sup>st</sup> May\*

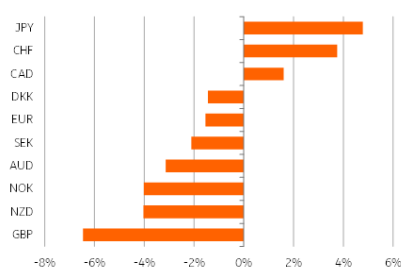
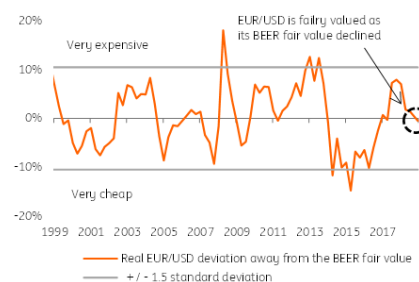


Fig 11 EUR/USD is not particularly under-valued



Source: Bloomberg, ING. \*May 1st 2019 when US-China trade truce collapsed.

## The euro continues to sink

Heavily exposed to the global trade cycle, the EUR continues to sink. EUR/USD also faces the added threat of Washington turning its attention to EU auto imports in November – perhaps at a time when Brexit weakens Europe. At the same time, the ECB will be re-starting asset purchases, locking European interest rates to their new floors.

Can under-valuation save the euro? Our medium-term models, designed to assess fair value over a 2-3 year horizon, actually suggest EUR/USD is fairly valued near 1.10. Given that EUR/USD can easily trade +/-15% around fair value, the ground beneath EUR/USD looks soft. That's why we think EUR/USD may be breaking into a 1.05-1.10 range.

## Sticking to our guns on sterling

Brexit continues to confound most scenario analysis although we are still happy with our 3Q19 calls of 0.95 for EUR/GBP and 1.18 for Cable. What happens thereafter is any-one's guess, though we are more minded towards 1.00 and 1.10 for EUR/GBP and GBP/USD as 'no-deal' Brexit probabilities rise and the alternatives – a minority opposition government with attendant fiscal or Scottish independence risks – doesn't look too attractive either.

## Author

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.