

FX: It ain't looking pretty

An escalating trade war, rising oil prices and a late cycle US economy suggest safe haven currencies will continue to outperform



Source: Shutterstock

➔ USD: Nationalist tone in US-China trade war is worrying

Chief Investment Officers must be considering more defensive strategies right now. It has not been a bad year for asset market performance, with the MSCI World equity index up 13% and some common bond indices up 2-3%. But now faced with: a) an escalating US-China trade war taking on some unedifying nationalist tones, b) oil rising on supply concerns as Iran is backed into a corner in the Middle East and c) a late cycle US economy, investors will be focused more on preserving capital. This dark mood is playing out in the FX space, where any rallies in commodity currencies quickly fizzle and USD/CNH is the focal point for US-China trade tension. USD/CNH has traded as high as 6.9450 today and were it to hit 7.00, alarm bells would ring even louder around the world. It would be a surprise if equity markets were to hold onto this week's recovery and the safe havens of the US dollar, Japanese yen and Swiss franc will continue to outperform. Our preference remains the yen here, given our concerns that the S&P 500 could turn lower again. It's a light day for US data, just US consumer sentiment, and we'd expect risk assets to stay fragile as the market awaits the next response from China. DXY to trade 97.50-98.00, but watch out for fresh losses in USD/JPY.

⬇️ EUR: European elections merely add to the soft EUR environment

Trade wars are exacerbating deflationary trends and leaving the euro under pressure. The pressure from the external environment is being compounded by electioneering ahead of the 23-26 May European elections – especially where Deputy Italian Prime Minister Matteo Salvini wants to model himself on the rule-breaking Donald Trump. Expect to hear more of this over the next week. Broad pressure on emerging market FX is also leading to broad dollar demand, which typically pressures EUR/USD. Look for EUR/USD to move to 1.1110/30 and EUR/CHF to cause more headaches for the Swiss National Bank down at 1.1200.

⬇️ GBP: Much more political uncertainty

Given the prospect of: (a) A Tory drubbing in European elections, (b) May's Withdrawal Deal being rejected for a fourth time in early June and (c) a formal leadership contest starting shortly thereafter, we doubt investors will want to go anywhere near the pound. There is also a lot of room to re-build speculative GBP shorts after these were completely unwound over the last six months. Cable -> 1.2670.

➡️ TRY: Improving US-Turkey relations

Recent speculation over improving relations between the US and Turkey was given some support yesterday when the US cut its tariffs on Turkey's steel imports to 25% from 50%, unwinding the increase from last August. At the margin this could provide some relative support for the Turkish lira.

Author

Chris Turner

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

chris.turner@ing.com

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