FX: Keeping the faith

Risk assets have started the year well amid solid US data and a more dovish Federal Reserve. Here's what we think this means for the dollar

Source: Shutterstock

USD: US data keeps positive risk mood alive

Despite much focus on a global slowdown amidst trade tensions and late cycle economies, risk assets have started the year well. Global equity markets have posted 4-10% year-to-date gains in US dollar terms, credit spreads have narrowed – particularly in emerging markets – and industrial metals, a key barometer of global activity, have actually rallied 8% from December's lows. Friday's US jobs data (strong jobs growth, steady wage data) should see investors keeping the faith with this bullish trend, where it will probably take several months to shift from high cash levels and under-invested positions. This week is a relatively quiet one for economic data, and the China Lunar New Year holidays suggest Asia won't be a source of volatility. This presents a mixed story for the dollar. It should retain its strength against the low yielders of Japan and Europe, while still staying soft against high yielding G10 and emerging market FX currencies. This has been the core theme through January, but unless US-China trade tensions flare up again (talk of a Trump-Xi summit in late February should keep risk supported) or a No Deal Brexit becomes likely, we'd expect this cautiously risk positive environment to continue. For reference, President Trump delivers his State of the Union speech tomorrow night. DXY to stay steady in a 95-96 range.

EUR: One year EUR/USD traded volatility sinks through 7%

The FX options market believes EUR/USD is going nowhere fast and the price for one year EUR/USD implied volatility has sunk below 7%. This has traded down to 6% (both in 2007 and 2014), but in the twenty year life of the euro, current levels are exceptionally low. We continue to see the euro as undervalued, but until some clearer signs emerge of a US slowdown (and not just a Fed pause) or some good news emerges from the eurozone (fiscal stimulus, strong domestic demand?) we expect the euro to stay subdued. We're also slightly fearful of negative developments on US auto tariffs over coming weeks – thus would stay cautious on the euro. 1.14-1.15 looks the range this week.

GBP: Ball is in May's court

Prime Minister Theresa May is in Downing Street today, preparing a new Deal to take over to Brussels. We'll probably see another week of intransigence out of Brussels, keeping those No Deal fears on the table. Sterling might stand a better chance of recovery when those amendments return for a vote in parliament – i.e. a No Deal is formally taken off the table. Cable risks drifting to 1.2920.

JPY: One of the preferred funding vehicles

USD/JPY has nearly reclaimed the 110 level and its best hope of a move to next resistance at 111.40 may come from the State of the Union speech tomorrow – were President Trump somehow to put fiscal stimulus on the agenda again.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

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.