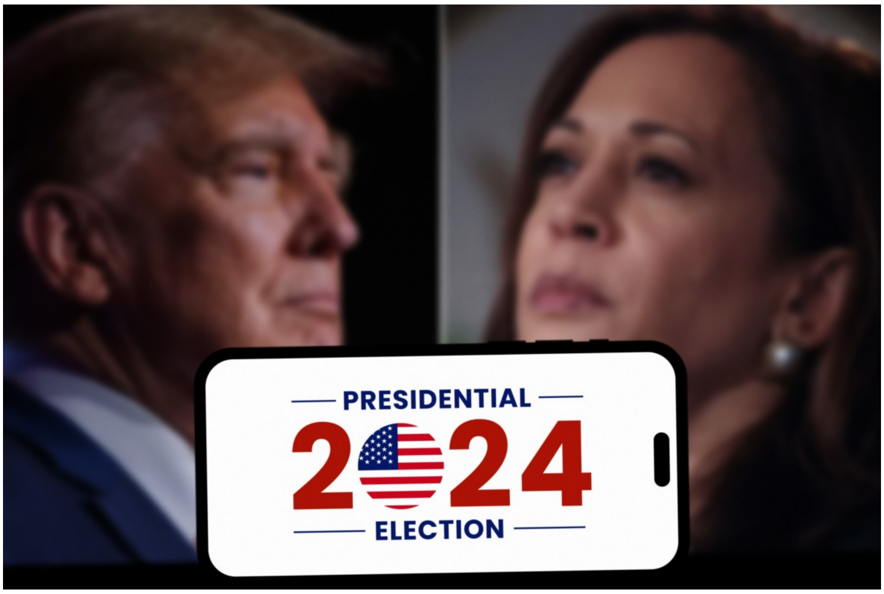
FX: November will be a game-changer

US elections in November will be a game-changer for FX markets. We continue to flat-line our EUR/USD forecasts after November until the US political situation is much clearer. In the meantime, we take a slightly bearish view of the dollar before the Fed's first cut in September



Donald Trump will face Kamala Harris in the US elections on 5 November

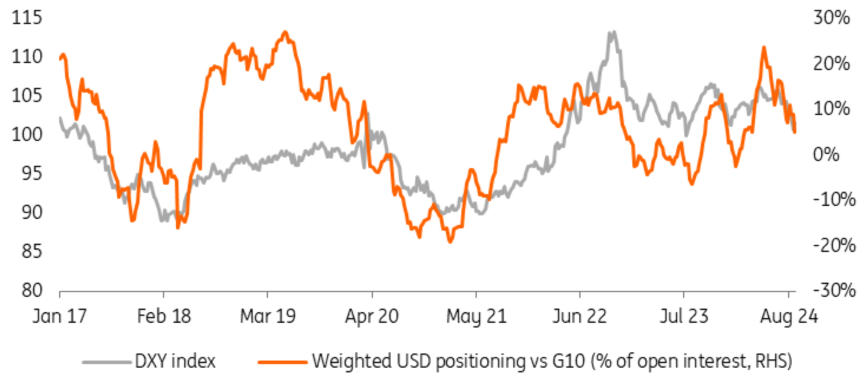
It's been both a yen and a dollar story

Those lucky enough to have had a long summer holiday will be coming back to find the dollar just over 4% off its highs seen in early July. That move can be attributed to developments coming out of both Japan and the US. On the former, the disorderly unwind of the yen carry trade - and its fall-out on global risk assets - briefly had the market pricing an emergency Fed rate cut in early August. And the speed of that USD/JPY adjustment owed a lot to extreme short yen positioning, a more hawkish Bank of Japan, and a more aggressive BoJ FX intervention policy.

Since then, asset markets have settled, and we have started to see a more orderly, broad-based dollar decline. Perhaps that has been most evident in the recovery in Asian currencies, which have enjoyed their first meaningful rally since last November. As James Knightley discusses, the Fed's confidence in the disinflation process and concern over the jobs market have been a big driver in this dollar decline.

These forces have seen speculators pare back their net long dollar positions, as you can see in the chart below. This community now awaits the 'next big thing'.

Speculators have cut long dollar positions back to flat



Source: ING, CFTC

The next big thing

That next big thing is undoubtedly the US presidential election in November. Given the power invested in the executive branch and what it can mean for trade and foreign policy, the outcome will determine whether global trade has to suffer a repeat of the 2018/19 experience. Equally, were the Republicans to win both branches of Congress, the dollar would be buoyed by loose fiscal/relatively tighter monetary settings.

If the Democrats win out, market expectations of status quo politics would see investors focus on the Fed easing cycle, and the dollar would probably weaken. We discuss all this in our US Presidential Election: Three Scenarios for Markets article published last month. We'll await the election results before taking a medium-term view on the dollar.

Before then, we have a slight bias that the dollar stays soft. The start of Fed easing cycles and bullish steepening of the US yield curve is normally a bearish time for the greenback. Assuming US activity, especially employment data, continues to soften, we would expect the dollar to be heading into the November elections on the weak side.

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