FX: Mideast tensions make USD the go-to safe haven

Middle East tension, trade wars, the Federal Reserve and Brexit should keep the dollar bid

USD: The dollar is the preferred safe haven right now

Looking across the spectrum of market drivers right now, i.e. Middle East tension, trade wars, Federal Reserve, Brexit, we suspect that most of those are dollar positive risks. We published a brief overview yesterday on the market implications of events in Saudi Arabia, with exposure to the oil market already a key driver of FX trends this week. Beyond the temporary lift to the dollar provided by tight overnight rates ahead of the 16 September US corporate tax deadline, we believe there are three good reasons why the dollar will prove the key safe haven currency right now: (1) The US is close to energy independence (would you hold the Japanese yen right now given Japan's high energy dependency ratio?), (2) given low tax wedges, higher oil prices have the highest pass-through to inflation in the US, according to IMF studies and (3) with core inflation already above the Fed's target, the Fed may have the least room to look through the coming spike in inflation – all conditional on this oil disruption continuing. Potential dollar negatives are perhaps some softening in the trade war (Chinese vice Fin Min is heading to Washington tomorrow to talk trade) and perhaps news from TIC data tonight that China has continued to reduce US Treasury holdings, but we'd prefer to side with the dollar right now. Favour DXY making a run back to the high at 99.37.

EUR: Higher oil prices won't be welcome

Faced already with the US-China trade war, disruption to the German auto industry and Brexit, higher energy prices won't be welcome to the European industrial sector right now. Currently the interest rate market looks to be pricing another 30bp of ECB deposit rate cuts into next year and there seems very little reason to be looking to buy the euro. Look out for German ZEW investor sentiment today, where another new low is expected in the collapse in confidence from March 2018. EUR/USD can retest the 1.0925 lows.

GBP: Downing Street keeping its cards close to its chest

Prime Minister Boris Johnson's visit to Luxembourg didn't go too well and the message seems to be that Downing Street is offering few fresh ideas on a deal. Whether that is a cunning plan – holding back fresh initiatives until closer to the 17 October EU summit – remains to be seen. For today, the focus will be on the UK Supreme Court considering whether the pro-rogueing of parliament was legal. The hearings will take three days. There is a good chance that cable put in a near term top at 1.2525 yesterday. Favour a return to 1.22.

KRW: Korea's energy dependence leaves KRW vulnerable

Should Saudi oil exports remain restricted or Mid-East tensions escalate, Korea's energy dependence could weigh on the Korean won. 1200 beckons for USD/KRW.

Author

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