FX: Slow starter

With no clear sign of a US slowdown and few compelling investment stories overseas, the dollar remains well supported. But for how long?

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USD: Slow start to the year keeps the dollar supported

For a significant dollar bear trend to develop, we probably need to see either: (a) clear signs of a US slowdown/US-centric risk or (b) compelling investment stories overseas. The reality is we've seen neither so far this year and that's why the dollar has generally stayed steady/bid over the last few weeks. In addition, high yield under-valued emerging market currencies have typically outperformed their steep forward curves and we've seen a few modest re-rating stories, e.g. the prospect of a second referendum lifting GBP and a new bank tax hitting the Romanian leu. It looks as though this environment can rumble on for a couple of weeks as we await fresh inputs on the US government shutdown, trade relations and also whether there are any clearer signs of a global slowdown – which generally seems to be the mood coming from Davos. Until such fresh inputs are received, we would expect the DXY to remain supported in a 96-97 range.

EUR: Waiting on the ECB

EUR/USD is going nowhere fast and now awaits tomorrow's ECB meeting – see our preview. Eurozone money market rates continue to languish near their 2018 lows and clearly, the market is not expecting any fireworks from President Mario Draghi. The good news for corporates is that

EUR/USD hedging costs through the FX options market are dropping (one-year implied volatility now back at 7.2%) even if the expensive dollar forward points are not correcting much further. We see EUR/USD going nowhere fast.

GBP: Labour warming to an Article 50 Delay

The Labour Party now seems to be formally backing a delay to the Article 50 process, which we'll likely hear a lot more about assuming Prime Minister Theresa May again loses a key vote on 29 January. Cable could briefly break above 1.30, but as Petr Krpata noted yesterday, a probability-weighted outcome for EUR/GBP is probably around the 0.89 area – thus we doubt investors will chase GBP too far.

RON: Grabbing the headlines for the wrong reasons

A depreciation in the Romanian leu has been a key highlight of the year so far as investors come to grips with the government's decision to impose a relatively large (by prior central and eastern European standards) tax on banking sector assets and link that tax to the Robor policy rate – limiting the National Bank of Romania's room for manoeuvre on monetary policy. Typically, the NBR is very active in FX markets, because of the high pass-through of leu weakness to inflation, thus the recent sharp break in EUR/RON above 4.70 raises questions as to where a new trading range can develop. Expect the leu to remain fragile as investors continue to seek answers as to how the bank tax will affect the local banking system and at what levels the NBR will seek to exert greater control over the exchange rate.

Author

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