FX: Source of uncertainty

The ECB follows the Fed in releasing minutes of its last policy meeting later. The report could weigh on the EUR/USD

Source: Andrej Klizan

USD: FOMC minutes provide some support, seven-year auction in focus

The release of January FOMC minutes has given the dollar a small lift, with confidence expressed that activity and inflation have been moving in the right direction to merit further gradual rate hikes. The USD OIS curve looks to have priced Fed hikes for March, June and September now and is starting to think about a December hike, too. The Fed story has not had much bearing on the dollar over recent quarters, as a recovery in investment opportunities overseas and more recent concerns about Washington's dollar policy and twin deficits have driven the dollar lower. We think there is a lot more dollar weakness to come. After a speech from Fed's William Dudley at 16:00 CET today, the dollar focus switches to the 19:00 CET US$29bn auction of seven-year US Treasuries. The last auction received quite a high 2.73% bid-to-cover and 78.1% indirect bid (typically representing foreign reserve manager interest). Any poor showing of interest at the auction could add to fears that US asset markets are falling out of favour. That said, watch out for key resistance in DXY at 90.56 – above which a 2% dollar rally is threatened – but overall we see this as a temporary dollar correction.

EUR: ECB minutes released at 13:30 CET

The highlight today will be the release of the ECB minutes of the January 25th policy meeting. This was the meeting when the ECB failed to put a lid on the Euro – effectively acknowledging the strong economy. At the time the ECB said 'recent volatility in exchange rates represents a source of uncertainty'. Presumably, the ECB will try to develop this theme in the minutes, which could weigh on EUR/USD. If key support does not hold at 1.2200/2210, we could be looking at a 1.2070/2100 and even a 1.19 scenario ahead of European political event risk in the form of Italian elections on March 4th and the German SPD vote on the coalition government. Also look out for a potentially softer German IFO.

ZAR: Aggressive budget hopes to avoid Moody's downgrade

The South African rand is holding onto gains after a well-received budget yesterday. A ZAR50bn budget shortfall last October sparked a run on South Africa's assets, but yesterday's 2019 budget addressed that with, amongst other things, the first VAT increase since 1993, expected to raise ZAR23bn. The tighter budget is designed to appease Moody's, which is expected to retain local South African government bonds (SAGBs) on an investment grade rating later this month - thereby avoiding large sales of SAGBs that a downgrade in local ratings to junk would have caused. South Africa's sovereign credit default swap is back down to levels last seen in 2013 and it looks like investors like the 8% yields available in SAGBs. We feel fair value for USD/ZAR is somewhere in the 12.00/12.50 area.

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