FX: State of play

The Fed isn't about to change direction any time soon and volatility in emerging market currencies looks set to continue. But so often we've seen positioning dominate short-term FX developments. And the market is heavily long dollars....

Source: iStock

USD: Many cross-currents right now, positioning may dominate

There are so many cross-currents in FX markets right now it's probably worth taking stock of where we are:

1. The US economy is doing well currently, but the US Treasury curve is flattening further and suggests we are moving to the latter stages of the US business cycle
2. President Trump is showing no signs of backing away from protectionism, and the imposition of tariffs on $200 billion of Chinese imports in late September would accelerate fears of a slowdown in China and exacerbate tensions in emerging markets
3. Trump doesn't want a stronger dollar but will struggle to turn the trend unless the loose fiscal/tight monetary policy mix is changed
4. The speculative market is heavily long dollars and at risk of position adjustment.

So what's next? It seems a little premature for the Fed to be shifting direction just yet (Fed Chair

Jerome Powell makes opening remarks at the annual economic symposium in Jackson Hole today at 16:00CET) and further pressure on emerging market currencies looks the conviction call over coming months because of tariffs and sanctions. But so often we've seen positioning dominate short term FX developments. Thus there's a good chance the short term DXY rally stalls in the 95.70/96.00 area before the dollar dips back to 95 again. 111.50/112.00 may prove the top in USD/JPY too.

EUR: Trump to the rescue!

There has been an early headline today that Trump is said to offer help in buying Italian government bonds. It's not clear whether this relates to relief efforts after the Genoa tragedy or part of a broader plan. Heavy short euro positioning suggests EUR/USD finds support in the 1.1500/1530 area near term.

GBP: Big level at 0.9030 in EUR/GBP

EUR/GBP is pressing the top of a 0.9030 to 0.8620 11-month range. There seems enough uncertainty over a no-deal Brexit to trigger an upside break-out.

ZAR: Unwelcome attention

The South African rand (ZAR) came under pressure on Thursday after a Trump tweet that instructed US Secretary of State, Mike Pompeo, to closely look into the expropriation of land in South Africa under the ANC's land reform. Investors, understandably, felt that South Africa could become another victim of US mid-term elections with the threat of US economic sanctions unless the ANC changes policy. South Africa runs a $1-2 billion trade surplus with the US and enjoys tariff breaks under the AGOA scheme for Sub Saharan Africa introduced by Bill Clinton. Presumably, Trump could threaten to withdraw South Africa's eligibility from this programme. The ZAR is a highly volatile currency with some vulnerability on the external financing side (5% of GDP current account deficit in 2Q18 and low FX reserves). Given a pretty vulnerable emerging market backdrop (higher US rates, significant trade tariffs, China slowdown) we could well be entering another 15+ period for USD/ZAR.

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