FX Strategy: GBP, no respite in sight

The pound continues to be under pressure while the US dollar stays supported

USD: The contagion from Argentina woes to be limited and not long lasting

Despite yet another leg of a dovish repricing of the Fed outlook, the dollar stayed supported, getting a boost from the safe haven flows stemming from the sharply rising political uncertainty in Argentina. The hit to risk assets globally was obvious yesterday, yet we expect the contagion to be limited and not long lasting (as evident on the overnight price action where G10 FX crosses have been fairly stable) as the Argentinian woes should be seen as idiosyncratic event. In addition, given the close nature of the LatAm economies, the relative negative economic spill over may not be as profound as would be case elsewhere (ie, DM or EM Europe where local economies are fairly open).

On the data front, the focus today is on US CPI. The ex-food-and-energy reading should remain above 2%, yet it should have a limited effect on market expectations of the Fed path given the overriding theme of US-China trade wars

EUR: Tentatively benefiting from lower US rates

While German August ZEW is unlikely to provide a cheerful story today and should underline the case for the ECB easing in September (particularly when the trade war outlook worsened), EUR/USD currently benefits from additional dovish repricing of the Fed. With the market pricing the ECB depo rate already close to -0.70% by mid-2020 (which could be seen as a soft floor for EZ rates), the ECB needs to over-deliver on the QE front in September to push EUR/USD below 1.10 and offset the current ongoing dovish repricing of the Fed (which could accelerate should trade tension increase). This supports EUR/USD for now – which is currently trading close to its short-term financial fair value.

GBP: No respite in sight

While the June UK wage growth may well hit another post-crisis high, any spill over into the market expectations of the BoE policy stance should be fairly non-existent as the Brexit uncertainty takes precedence over the monetary policy outlook. We view any days of GBP strength as a fade (such as yesterday) and see more sterling weakness ahead as we get closer to potential early elections (see GBP: The sterling meltdown), a road to which will still be very tricky and characterised by hard Brexit risks. Although the speculative community is fairly short GBP (35% of open interest vs USD), above 40% levels are still achievable (as was the case in 2017) given the nature of the possible future shock.

JPY: Benefiting from the best of both worlds

JPY benefits from the best of both worlds (risk-off environment and the dovish re-pricing of the Fed). Based on a slowing US economy and the Fed cuts, we maintain a view that USD/JPY will head down to 102/103 area later this year.

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