

FX: Survival of the fittest

President Trump's comments that 'we don't have to go as fast' on rates seem to have stalled the dollar rally temporarily while Treasury Secretary Steve Mnuchin warns China on currency devaluation



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➔ USD: Dollar rally takes a pause

Comments by President Trump that 'we don't have to go as fast' on rates seem to have stalled the dollar rally temporarily. Asian equities have had a relatively quiet night, but the focus very much remains on USD/CNY and the 7.00 level after it traded close to the highs of the year on Monday. In an [FT interview](#) today, US Treasury Secretary Steve Mnuchin warns against a managed CNY devaluation although in reality the June-July decline in the renminbi looked like a market-led move and since late July, the renminbi has been flat against a basket of trading partners. In terms of the overall outlook, until we see: (i) clear signs that the market has confidence where the top is for the Fed cycle and (ii) Washington softening its stance on China and trade, we would expect the dollar to stay supported against emerging market and pro-growth currencies. We acknowledge the market is already positioned for this de-synchronised world growth story and the best hope for at least a correction in the dollar is probably the [US mid-term elections](#), where a loss of the House would curtail most hopes for fresh fiscal stimulus. For the time being, however, we see the dollar staying bid on dips and those EM currencies with large twin deficits staying on the back foot. We appreciate it's tempting to buy some undervalued EM FX with high yield (Brazilian real, rouble offer

around 6% annualised implied yields through the 3-month forwards and the Turkish lira offers 27%), but external headwinds to EM suggest patience.

➔ EUR: Hanging in there

EUR/USD may be due a little consolidation after its fall from 1.18, but may struggle to get above the 1.1560/1620 area near term. It's going to be a noisy month in the [Italian budgetary process](#), particularly in the second half of October when the European Commission and the ratings agencies get to review it. The best hope of a EUR/USD recovery may come from some better news on Brexit, but with the dollar staying strong and China fears growing, we think 4Q18 will be a story of survival for the beleaguered euro.

⬆️ GBP: Some cautious optimism emerging

The pound once again is being buoyed by expectations that some kind of Brexit withdrawal deal can be struck before the 17 October European Council working dinner on Brexit. We've been here before, but this GBP move might have a little further to run – especially against activity currencies of the Australian and New Zealand dollars.

➔ ZAR: Short-lived rally?

The South African rand (ZAR) is rallying after the appointment of the well-respected Tito Mboweni as South Africa's new Finance Minister. The ZAR is undervalued and the implied yield on the 3-month forward is attractive at 7.3% annualised. Yet the China story will take its toll on the rand. 14.00/14.15 is now really big support for USD/ZAR.

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