

FX: What to do in a stalemate?

The US government shutdown is entering its 28th day. But the Fed is on hold and the mood music on US-China trade relations is improving. So how should you position?



Source: Shutterstock

➔ USD: No signs of an end to the government shutdown

As the US government shutdown enters its 28th day there are still no signs of the impasse ending. Both the Republicans and the Democrats will be stepping very carefully, desperate to avoid a miscalculation that could see them lose the blame-game. Financial markets are also stepping carefully around these issues, but without clear evidence of the impact this is having on the US economy, are prepared to look for the positives in 2019. The Fed pause is a large positive for risk and investors are also tentatively responding to better mood music coming through on US-China trade relations. A [WSJ report yesterday](#) that Treasury Secretary Mnuchin wanted cuts on Chinese trade tariffs was quickly denied – but the more constructive tone here could last through the month ahead of fresh trade talks in Washington 30/31 January. US equities have now recovered 50% of last year's sell-off, but US 10-year yields have been slow to recover. Our bias is, however, that the US curve can gently re-steepen and that the dollar can recover some more ground against the low-yielders (a higher USD /JPY is our preferred call here). And barring local stories, we think selective high yield can start to perform. Please see all our latest views in this week's [FX](#)

Talking.

⬇ EUR: Our eurozone team paints a bleak picture

Our eurozone macro team published its [quarterly update yesterday](#), painting a very cautious picture for the region. The European Central Bank will struggle to do more than lift the negative deposit rate this year. It's a soft environment for EUR/USD then, particularly while the dollar stays strong in the first half of the year and the fact that it's barely budged on GBP's gains warns of ingrained pessimism. Expect a 1.1300-1450 range near term and the euro to be considered a funding currency.

⬆ GBP: Scope for some more tentative gains

A potential path to a second referendum is lifting sterling and this story may have a little more to run in that various amendments look set to be debated in parliament early next week, including a second referendum. But until Prime Minister Theresa May manages to unlock [her stalemate with Jeremy Corbyn](#), cable gains could be limited to around the 1.31 area.

➡ CAD: Decelerating headline CPI unlikely to change the BoC stance

As per [Canadian Inflation Preview](#), our economists expect December's headline inflation to be depressed by the slump in energy prices, decelerating to 1.6% year-on-year from 1.7% in November. Yet, this is unlikely to overly concern the Bank of Canada unless we also see a drag on core figures. We expect the BoC to resume the tightening cycle in line with the Fed, with the next BoC hike coming in July in our view. This points to CAD being an outperformer vs the other two dollar block currencies (AUD, NZD) this year.

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