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Article

Global FX: This is a political world

Reports that a Chinese delegation will be heading to Washington for trade talks have added to the dead cat bounce that we've seen in risky assets

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USD: Trading hopes of a better political world has been pretty unrewarding

Global markets have been marred by an ever-changing geopolitical backdrop so far this year – and this week has been no different. Reports out of Beijing that a Chinese delegation will be heading to Washington later this month for low-level trade talks have added to the dead cat bounce that we've seen in risky assets after the stabilisation in the Turkish lira (TRY) this week. Indeed, the Chinese yuan – which has been another big source of market risk – has also moved higher on the US-China trade story (though we note the slightly stronger People's Bank of China CNY fixing as well). Still, trading hopes of a better political world have proved to be unfruitful – with the reality being a lot more damning in this new protectionist world. Elsewhere, watch out for an investor call being held by Turkey's Finance Minister Berat Albayrak later today (1400 GMT) – with TRY set to remain sensitive to Ankara's next policy steps.

EUR: A lot of bad political news priced in but still too early to price out

The link between EUR/USD and peripheral European swap spreads suggests that there may be hefty three-four big figures worth of idiosyncratic European risks (Italy and Turkey) priced into the single currency – although we still feel that it may be too early for any of this to be priced out. EUR/USD to remain capped at 1.14.

While we don't expect the Norges Bank to hike today, our economists think that the central bank will reiterate its intention to raise the policy rate in September. The fragile external environment may be masking how a hawkish Norges Bank is being reflected in EUR/NOK, but we expect the krone to remain a relative G10 FX outperformer – with NOK/SEK moving higher on the basis of diverging central bank outlooks. EUR/NOK could take a look at 9.50 on a hawkish NB signal today.

GBP: Short-term weakness in the politically-infested pound too hard to fight

GBP/USD has been unravelling in recent weeks – although most of this has been due to extrinsic factors, with GBP assets hit by a double dose of risk premia:

(1) a UK-specific risk premium capturing the obvious heightened no-deal Brexit risks and (2) a global risk premium stemming from geopolitical uncertainties and emerging market turmoil. Both have left GBP/USD trading at a significant discount from short-term fundamentals – with no amount of UK data providing support (FYI we have July retail sales today). While we may already be at our GBP/USD 1.27 target, the persistence of these 'twin risk premia' could see us undershoot

this level in the near-term (with risks of a move down to 1.25-1.26). Equally, we are uncomfortable about chasing GBP much lower now – especially in the absence of any tangible signs that we’re heading towards a no-deal Brexit. The prospect of a last-minute deal (as history has proven) on the Irish backstop means that risk-reward no longer favours pricing in no-deal Brexit risks – with scope for a sharp GBP rebound in this scenario outweighing any momentum driven moves lower.

IDR: BI leading the way with defensive hikes amid a period of EM FX turmoil

Bank Indonesia surprised with a 25 basis point hike yesterday in a bid to stabilise the rupiah (IDR) – and we now feel that further tightening is on the cards until the currency does in fact steady (there were also government measures aimed to provide FX support). With USD/INR close to 70, the Reserve Bank of India is also likely to be coerced into more aggressive tightening. Defensive rate hikes will be in vogue and we could start to see emerging market FX differentiation based on the willingness of policymakers to step-in. The RBI’s laggard approach could see the rupee underperform the yuan-sensitive Singapore dollar.

