Gold adds to peak dollar view

The prospect of the real Fed Funds rate turning negative has sent gold through $1400/oz and adds weight to views that the dollar has topped

Source: Shutterstock

USD: Middle East tension undermines some of the demand for risk

Market-based measures of inflation expectations have bounced from their lows this week following a clear dovish shift from the Federal Reserve and European Central Bank. These expectations will have also seen some unwelcome support from events in the Middle East where, according to the New York Times, Washington was very close to delivering retaliatory strikes after Iran downed a US drone yesterday. However, it seems the market is unwilling to enter a full flight-to-safety mode, which would have seen equities sharply lower and a much more inverted options volatility curve in USD/JPY. Instead, the market is taking its lead from the central banks. Importantly, the prospect of the real Fed Funds rate turning negative (especially were the Fed to cut 50 basis points in July) has sent gold through $1400/oz and adds weight to views that the dollar has topped. We favour a weaker dollar this summer, but based on our trade team's view of an escalation in tension in 3Q19 continue to favour the defensive currencies of Japanese yen and Swiss franc against the dollar.

EUR: June PMIs unlikely to offer much solace to the EUR

Today sees the release of June business confidence figures for the euro area. It's not clear whether Mario Draghi's dovish remarks at the June ECB meeting would have been enough to trigger much of a rebound in manufacturing confidence, which is languishing near the lows both in Germany and across the eurozone. Another poor set of figures will firm up expectations of a 10 basis point deposit rate cut at the 25 July meeting and keep the EUR offered on the crosses, especially against JPY and CHF. It's also worth keeping an eye on euro area banking stocks, after Natixis fell 11% yesterday on fears of poor oversight of one of its asset managers. This won't help the euro either.

GBP: Brief reprieve for the pound (against the EUR)

Tory party members will now be voting on Boris Johnson and Jeremy Hunt for the next leader and Prime Minister, with the result due in the week commencing 22 July. Johnson is the firm favourite and based on our scenario analysis of a Johnson leadership, the pound could run into trouble this autumn. Before then, focus on ECB easing could drag EUR/GBP a little lower.

CNY: Will the PBOC be fixing CNY stronger ahead of the G20

The People's Bank of China fixed USD/CNY markedly lower at 6.8472 overnight, responding to market-led Chinese yuan gains on Thursday. In the past, the PBOC has been seen to fix the CNY stronger ahead of major bilateral/G20 meetings. This bias to limit USD/CNY upside with flat fixings (e.g. just below 6.90) and then participate in USD/CNY downside can provide some stability to emerging market activity currencies, e.g. the South African rand.

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