FX markets remain in a holding pattern

FX markets are becalmed as investors continue to fine tune the starting dates for 2024 easing cycles. The dollar's high yield is keeping it attractive, especially given simmering geopolitical risks. We expect this trading environment to continue for some time and only expect a broad, bearish dollar trend to emerge through the second quarter

The presumption is that a potential Trump administration will be good for the dollar and bad for the likes of the peso and the Chinese renminbi, but a lot of this still hangs in the balance for the time being

It has been a relatively quiet start to the year in FX markets. Doubts about the timing and speed of central banking easing cycles have contributed to lower levels of volatility and a search for yield. Step forward the dollar with one of the highest yields in the G10 FX space and the added benefit of liquidity – useful should geopolitical or US regional banking stress escalate.

We continue to expect this range-bound environment to give way to a broader dollar decline during the second quarter. We had a sneak preview of this environment in the last two months of 2023. Assuming the Federal Reserve is preparing to cut rates in May/June, the bullish steepening of the US curve should be positive for most activity currencies – including the euro. We still forecast EUR/USD ending the second quarter somewhere near 1.10 and ending the year at 1.15. The year-end consensus forecast for EUR/USD is 1.12.

Before then, subdued volatility in the FX market favours the carry trade. Yen-funded strategies remain popular and target currencies in the emerging world are those of the Mexican peso and the

Turkish lira.

Talk of the peso focuses the attention on the US election and the potential return of a Trump administration. We can certainly see investors pricing more volatility into FX markets after November. The presumption is that a Trump administration will be good for the dollar and bad for the likes of the peso and the Chinese renminbi. We would only caution that November is still over six months away, and the make-up of Congress – and the ability to deliver large fiscal stimulus – will also have a large say in whether any Trump administration does prove dollar-positive.

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