More pain for US dollar shorts?

US GDP data today, plus price and jobs data next week, suggest the dollar short squeeze could extend a little further

Source: Shutterstock

USD: US 1Q18 GDP data could heap more pain on USD shorts

It's been a tough week for those short US dollar. What has surprised us a little recently has been the move at the shorter end of the US curve; three-month USD overnight indexed swaps priced one-year forward have risen 20bp this month to 2.43%. We had thought the endpoint to the Fed policy cycle was almost priced in, but instead, short rates are still moving and making USD hedging costs very expensive. This applies not only to the G10 majors, but has also cheapened up the hedging costs for some of the emerging market high yielders, such as the Brazilian real. 1Q18 US GDP data today, plus price and jobs data next week, suggest this short USD squeeze risks will extend a little further. The US dollar index has resistance at 91.70, above which the dollar could see another 1% advance. For reference, our team is a little above consensus for today's US GDP data. Any reading above 2% quarter-on-quarter annualised, given the normally negative seasonal adjustment in Q1, will be a good outcome.

EUR: USD correction broadens into Europe

Nothing much from the ECB yesterday has allowed USD strength to broaden into Europe, hitting not only the EUR but also other popular CE4 trades such as the Czech koruna. Momentum is with the USD for the time being and 1.2000/2050 looks to be the key 2Q18 battleground for EUR/USD. We can see it holding.

GBP: On the edge

Sterling has resisted the broadly stronger dollar relatively well, but today the pound faces a local challenge in the form of 1Q18 GDP. Consensus looks for 0.3% QoQ, but there are clearly risks to the downside from the cold weather and widespread reports of difficulty in the retail sector. Even though a 0.2% QoQ outcome wouldn't necessarily bury the chance of a May rate hike from the Bank of England, GBP would probably still suffer today. We see Cable support in the 1.3865/80 area, but a downside surprise on the UK GDP figure, combined with the broadly stronger dollar risks a temporary set-back to the 1.3780 area.

RUB: Tactical pause from the CBR today

Our Russian economist, Dmitry Polevoy, expects the Central Bank of Russia (CBR) to keep rates unchanged at 7.25% today and attaches a 30-40% chance to a rate cut. Fresh US sanctions and their impact on the rouble will probably prompt a pause in the CBR easing cycle and, at this stage, we still expect a further 75bp of cuts later this year. Any surprise cut today would probably be negative for the RUB – especially with the RUB already a little soft ahead of next week's holidays. For reference, RUB three-month implied yields are around 7% - the same as the South African rand and Indonesian rupiah. The Mexican peso offers 8% and the Turkish lira is now close to 14% (generating some much-needed TRY stability this week). However, after aggressive easing from Brazil's central bank, Brazil's real (BRL) implied yields are only 5.5%, which may leave the real a little exposed ahead of October's elections. We think cheap hedging costs will limit BRL upside this year.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com