Reality trumps tweets in FX, for now

Will the White House choose to take its trade war into the FX space?

FX markets have failed to catch the volatility virus

Global investors are having to contend with a myriad of Trumpian uncertainties: trade wars, geopolitics, sporadic stock market sell-offs, higher USD LIBOR rates and a highly leveraged late-cycle US economy. Oddly FX markets have failed to catch the volatility virus plaguing risky assets (especially equity markets), with the mixed signals sent by these idiosyncratic Trumpian uncertainties rendering currency investors into a state of confusion.

It feels that with each subsequent Presidential tweet, the bar for what actually constitutes risk-off in global FX and bond markets tends to increase – and it's now at a stage where one of the risks, be it a trade or geopolitical war, needs to escalate materially to influence those asset prices that track fundamentals. Equally, it does not look like any of these Trumpian uncertainties are set to fade away in the near-term. In particular, the US administration's trade policy has got most observers "spinning around" – the latest being that President Trump is now seeking to re-join the very same TPP trade deal that he withdrew from over a year ago.

Yet at the same time, reports state that the administration may be ready to unveil its $100bn tariff proposal on Chinese imports as early as next week (with the US also considering banning inward Chinese technology investment). Daily conclusions on whether US trade policy has escalated or de-escalated is fast-turning into a 'mug's game'; we feel that 'baffling' remains the best way to describe US trade policy at this stage. It's worth noting that one of the bigger risks specific to FX markets in the near-term is whether the US administration choose to take their trade clampdown into the currency arena.

We're expecting the US Treasury's FX report anytime now – and we note in our preview how officials could technically label Thailand a 'currency manipulator' (for more see Risks of trade war spilling into currency war increase). Doing so, in our view, would put additional pressure on trade surplus countries – like Germany, Japan and China – to stay clear of any policies that depress their currencies, which naturally lends itself to a weak USD (and strong EUR, JPY and CNY) trading environment. The trade-weighted $ could still fall another 5-10%.

ECB hawks eye 2Q19 rate hike... but will need more convincing EZ data

Geopolitics remains the number one threat to the ECB normalisation story, with the central bank otherwise confident over the broad-based strength of the euro area economy. That was the basic gist of the latest ECB minutes. EZ data is key for EUR/USD's direction, which remains stuck in the 1.22-1.24 range for now.

GBP: 'Darling of the FX world'... GBP/USD eyeing a move to 1.45 in 2Q18

While one may be inclined to chalk down GBP's bullish bias of late to seasonal factors, we've also been noting how 2018 is very much a different Brexit trading environment for the pound. Gone are the days of noisy Brexit headlines stirring sharp – and almost sentimental rather than fundamental – knee-jerk moves in the currency, with the buffer of last month's Brexit transition deal buying GBP investors some extra time to assess the Brexit facts.

And with the next stage of negotiations surrounding a future UK-EU trade deal set to be long-winded and complex, it appears that we're back to good old-fashioned UK data watching to determine the short-term direction for the currency. The week ahead shouldn't disappoint here given the array of key data releases to watch out for – including the latest UK labour market report (Tue), CPI data (Wed) and retail sales (Thu).