FX: Temporary calm

After a volatile week, global markets have paused for breath. US inflation data this week should support the view that the fundamentals remain positive

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USD: Most roads lead to a weaker dollar

Global equity markets are pausing for breath after a hectic week. The fact that the S&P 500 turned sharply higher from its 200-day moving average on Friday has provided some temporary stability to global markets (modest gains seen in Asia). The consensus view now is probably that the equity correction was largely technical in nature (e.g. wrong-footed short volatility strategies exaggerating the move) and that market fundamentals remain positive. That view should survive the week, given that Wednesday's release of US January CPI should decelerate to 1.9% YoY (largely on base effects) and avoid fanning the flames of the story that the Fed is behind the curve. How equity markets react to the US budget story is another matter altogether. President Trump will today release the President's 2019 budget, where reports suggest the plan to balance the budget in ten years will be abandoned. We have not seen US fiscal weakness yet emerge in securities like the US sovereign credit default swap, but the issue of large and growing fiscal deficits will likely weigh on the dollar over coming years. The dollar index could easily sink back into the 89.60/65 area.

EUR: Rallying at the dollar's expense

The European Central Bank's Ewald Nowotny has again highlighted the issue of the US talking down the dollar – suggesting it would be on the agenda at the forthcoming G20 meeting (March 19). That is probably the best chance the ECB has of keeping a lid on the EUR/USD since as Petr Krpata notes in a report today, the ECB has little ground to talk the EUR lower from the monetary policy side. The trade-weighted EUR is not particularly strong and we think it would take a 4% rise in the trade-weighted EUR (knocking 0.3% off 2020 Eurozone CPI) for the EUR to make a significant difference to the ECB policy equation.

JPY: USD/JPY still fragile

The reversal in correlation between USD/JPY and US yields has been one of the stand-out features of 2018. Protectionism and US fiscal concerns play a key role here and represent a shift from the benign decline in the dollar that we'd seen in 2H17. Despite Bank of Japan Governor Haruhiko Kuroda likely being appointed for a rare second term, we see a major change in the USD/JPY trend and imagine investors will use any USD/JPY recovery to 109/110 to put FX hedges in place for US exposure.

CHF: Where's the SNB?

The market will look to today's Swiss sight deposit data to see whether the Swiss National Bank was buying EUR/CHF last week. Low inflation (Jan should come in at 0.8% YoY) should support the SNB's dovish position and we think the market is too aggressive in pricing 57bp of SNB tightening by end 2019.

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