

US Fed chair unleashes relief rally

Comments from Federal Reserve Chairman Jerome Powell last week continue to support risk assets



Source: Federal Reserve

⬇️ USD: Weaker dollar but mainly against higher beta currencies

Risk assets continue to rally following Fed Chair Jay Powell's comments on Friday which pointed to a pause in the current Fed tightening cycle and downplayed market fears that the pre-set course of tightening will contribute to the global slowdown and dent risk assets even further. With equity markets moving broadly higher, we expect risk-sensitive currencies to be the prime beneficiaries vs the US dollar while the low yielders such as the euro or Japanese yen should lag in terms of gains vs USD. This is because stabilising risk appetite should eventually translate into some modest further Fed tightening (as per [our Monthly Outlook](#), our economists expect the Fed to pause this quarter and deliver two hikes later in the year vs the partial cut still priced in by the markets by end 2019) and be USD supportive. Here, the euro ticks the box. We don't expect today's US Non-Manufacturing ISM to be as dismal as the Manufacturing ISM release last week (as the latter is more negatively affected by trade wars). Coupled with the on-hold Fed, this should help to keep the current risk-friendly environment in place.

➡️ EUR: Limited upside potential

The expected deceleration in eurozone November retail sales should limit the EUR/USD upside in the current soft USD environment. While comments From Powell on Friday meant that the

euro recovered all of its post non-farm payroll losses vs the USD, the common currency has been generally lagging the rest of G10 FX. With the scope for higher US Treasury yields (vs the limited upside potential to eurozone yields, at least in relative terms as the ECB has few reasons to change its cautious stance) we continue to see upside to EUR/USD as fairly limited and expect the EUR/USD to stay below the 1.1500 level.

GBP: The positive one-off effect from sentiment on GBP to fade

After having been dramatically postponed in December, the Parliamentary debate on the Brexit deal resumes this Wednesday ahead of a critical vote on 15 January. The most likely scenario remains that Prime Minister Theresa May's deal will be rejected, potentially by a heavy margin. With Brexit uncertainty firmly in place, we expect GBP upside to be limited and the effect of the general market sentiment on sterling (from which GBP benefited heavily on Friday) to be short-lived as it is the Brexit woes that matter most for GBP. Look for EUR/GBP to converge back towards the 0.90 level.

NOK: Benefiting from higher oil prices

The Norwegian krone is currently one of the key beneficiaries of the risk asset recovery (both equity markets and oil). We see EUR/NOK at 9.80 as strong and expect the pair to trend lower, particularly as when oil prices seem to be stabilising.

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