Article | 24 January 2018

FX: America First, Dollar Last

As Trump heads to Davos to pitch his 'America' First' ideology, the dollar remains under pressure

Source: Shutterstock

USD: No surprise a structurally weak dollar is under pressure from ‘America First’

It feels like the next few weeks could be a watershed moment for world trade and protectionism – and yet there is an unnerving sense of serenity in markets. As Vice-President Pence confirmed, President Trump will be heading to Davos – ahead of next week’s pivotal State of the Union speech (31 Jan) – to pitch his ‘America First’ ideology. This remains a risk strategy for the dollar – and for a US economy that relies on the kindness of strangers to fund its structural deficit.

EUR: Rally starting to feel a bit long in the tooth, but ECB can’t alter the trend

Ahead of the ECB meeting tomorrow, today’s January Eurozone PMI data will give investors the first real sense of whether the euro area economy has continued its strong momentum into 2018. Evidence pointing to this – as we expect – would reiterate our view that it might prove slightly difficult for President Mario Draghi and his colleagues to argue against the fact that the recent move higher in the EUR has been supported by fundamentals – not least stronger EZ growth sentiment. EUR/USD trading above 1.23 ahead of the ECB event does feel a bit ‘long in the tooth’ (for now), but we would see any move lower as a technical correction – rather than a new trend. Central bank meetings do not change fundamentals. EUR/USD to anchor around 1.23 today – with the ECB event risk to curb upside.

GBP: Less noise helping the ‘trashy’ pound clean up its act; wage data today

After having eyed up the 1.40 level for a few days now, GBP/USD meaningfully moved through this key psychological barrier yesterday – and traded to a fresh post-Brexit referendum high. While it may seem acute to rationalise sterling’s move higher as a shift in market sentiment towards a ‘soft’ Brexit, we think that this would be a classic case of ‘ex post fitting’. In fact, if one wanted any other reason than broad-based dollar weakness, it’s that it all seems fairly calm for now on the domestic UK political front – at least relative to what we’ve become accustomed to in a post-Brexit world. Without getting too ahead of ourselves, GBP/USD trading at 1.50 is still a realistic possibility in late 2018 – but the onus is now shifting towards finding GBP-specific catalysts to take us there (if we were to break down our call for 1.50 in 4Q18 – it’s a function of a 3% appreciation in the pound and a further 4% depreciation in the dollar). In terms of GBP-specific catalysts, one potential source that we’ve cited is a hawkish re-pricing of BoE policy expectations – with UK wage inflation ultimately holding the key here. Any positive wage growth surprise in today’s UK jobs report (0930 GMT) will see GBP/USD stabilise above 1.40, with EUR/GBP testing the 0.8760/70 support area.

NZD: 4Q CPI to set the RBNZ policy tone – high bar for any shift in sentiment

New Zealand 4Q CPI data (early Asia Wed) will be the first major domestic data release of the year – and is likely to set the tone for central bank policy sentiment (at least in the short-run). Market consensus is for headline inflation to remain at 1.9% YoY (0.4% QoQ) – which would still technically be below the 2% midpoint of the Reserve Bank of New Zealand's 1-3% target range. Even in the case of a positive CPI surprise, the general expectation is that the RBNZ will have some tolerance for inflation to head towards the higher-end of the target range. Still, the robust local macro story means that we like NZD on the crosses. AUD/NZD could be open to a fall towards 1.05-1.06 – with US steel tariff threats weighing on iron ore (& AUD).