

USD: Enjoying the pause

Second-guessing about the Fed's next move on interest rates should be good for FX high yielders in holiday-thinned markets. But we think the tightening story will be back on track very soon



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➔ USD: Speculation on Fed pause allows high yield FX time to recover

FX markets are enjoying a short-term pause. Some recent Fed commentary and softness in US equities have encouraged thoughts that the Fed could soon pause its tightening cycle. We think markets will be disabused of this notion over the next couple of weeks – but for the short term, pause reigns. Given high USD cash rates, a Fed pause shouldn't necessarily mean much recovery in FX low yielders (although a further collapse in US tech stocks could see the Japanese yen come into favour). Instead, the pause is allowing high yield FX a window of recovery. Lower oil prices are also helping the likes of Turkey's lira and Indonesia's rupiah, which so far have had a torrid year. Holiday-thinned US markets could see this environment stretch into next week, but then inflation data and FOMC minutes could easily put the tightening story back on track. DXY looks steady in a 96.00/50 range.



EUR: European Commission launches Excessive Debt Procedure

As expected, the European Commission delivered a negative opinion on the Italian budget and in order to expedite things [looks to be launching](#) a procedure on Italy's debt rather than deficit levels. This process will run into January, although in theory, Italy needs to pass its budget in parliament by the end of this year - presumably creating more friction. EUR/USD is underperforming the recent correction in rate spreads and we doubt there is much interest to take it above the 1.1450 area - especially ahead of some soft eurozone PMIs due tomorrow.

➔ GBP: What's new?

It sounds like Sunday's EU Brexit summit in Brussels will go smoothly, which will then refocus the market on whether Prime Minister Theresa May can get her deal through parliament. That seems unlikely, but there is a growing voice for a People's vote on Brexit, with the choices being: a) leave on May's terms or b) Remain. Any growing possibility in a People's Vote could deliver a bullish surprise for GBP.

⬆️ ZAR: SARB marginally favoured to hike today

In what is expected to be a close decision, the South African Reserve Bank is expected to hike its policy rate 25 basis points to 6.75% today. That would take back the 25bp cut delivered in March, when USD/ZAR was trading under 12 and emerging market prospects appeared brighter. If the SARB does hike today, it will be seen as a defensive move, looking to get ahead of the expected pick-up in inflation into 1Q19. CPI is seen heading close to 6% in 1Q19 and a 50bp real rate might be seen as too slim - especially if US rates are rising again (as we think). The SARB will also be monitoring inflation expectations, where 10-year inflation-indexed bonds still show readings higher than the top of the SARB's 3-6% target range. We think the ZAR would welcome a hike and in quiet conditions (and a market trying to second-guess a Fed pause) USD/ZAR can enjoy a temporary dip to 13.60.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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