US Dollar: Hedging costs starting to bite?

Given the strength of the US economy and the likelihood of a further three Fed rate hikes, treasurers may be questioning whether it's correct to be running such high US dollar hedge ratios

Source: Shutterstock

USD: Signs of pragmatism from the White House may have helped the dollar

Even though the US 10-year yields did not push through 3.00% yesterday, the dollar still performed well across the board. The bias is slightly positive for the short term. Away from the yield story were signs of pragmatism from the White House. An overlooked consequence of the Russian sanctions in early April was its impact on aluminium, which had risen 30% as buyers tried to find alternative suppliers to Rusal. The US Treasury yesterday gave a five-month extension to seeking alternative suppliers and a 'sympathetic ear' (not something commonly associated with the US Treasury) suggests pragmatism may well come into play when the White House in mid-May hears the response from business to the proposed sanctions on China. For today we should see some more positive US data (consumer confidence, new home sales) which should see the dollar index pressing the top of the range near 91.00. We prefer to view this move in the dollar as a bear market bounce (Trump won't want to see the dollar rally extend too much) and look for renewed pressure on the dollar into mid-May.

EUR: One year EUR/USD forward points close to four big figures

For the last six months EUR/USD has been happy to ignore the sharp widening in interest differentials in favour of the dollar – largely we believe as investors prepare for the reversal in portfolio flows as the ECB QE policy ends. Yet rate spreads are so wide now that corporate treasurers may increasingly struggle to justify such high dollar hedge ratios. For example, one-year EUR/USD forward points are now 383 USD pips and given the strength of the US economy and the likelihood of a further three Fed rate hikes, treasurers may be questioning whether it's correct to be running such high USD hedge ratios – even though Trump's policies are erratic. It's hard to calculate what a reduction in USD hedge ratios means for the dollar, but this may be a factor that is lending the dollar some support – and requires some more positive remarks from the ECB to get the Euro rally going again. The focus today is German IFO. Should it hold up, as the Eurozone PMIs did yesterday, EUR/USD should hold support at 1.2150/2200.

GBP: Staying soft into Thursday

The British pound has moved lower with most currencies against the stronger dollar and we think looks a little vulnerable into a potential House of Commons vote on Thursday. Slight risks on the day of a correction to the 1.3890/3920 area.

EM: High yielders in retreat

High yielders such as the Mexican peso, Brazilian real and South African rand were under pressure yesterday. We think this owes as much to local politics as it does to higher US yields. There doesn't seem the case for major follow-through selling just yet given what seems to be an orderly rise in yields and still healthy global growth figures.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com