USD: MEGA, Make Everyone (else) Great Again

USD: In the FX world, Making Everyone else Great Again is the current theme

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Two things at play

Whether intentional or not, President Trump has certainly managed to keep his word on one of his pledges: concerns about a rising dollar are no longer an issue for the administration, with even the Fed's trade-weighted index now at its lowest in a year. When it comes to taking stock of the dollar's latest plight, we believe there are two things at play:

- First is the shifting view that the US economic cycle is beginning to top out, given the absence of any major Trump fiscal stimulus – in effect making the somewhat rich US assets unattractive in the eyes of a global investor.
- Second is the idea of a political risk premium weighing on the dollar; while it may be slightly premature to conclude this, it is certainly one explanation for why USD crosses have sharply decoupled from interest rate differentials in recent weeks.

This week's US data will be a big test of the latter idea; in theory, we would expect the USD to move higher in line with US yields were we to see a robust jobs' report on Friday. Wednesday ADP employment data may begin to whet the appetite for a dollar recovery, while Fed talk – albeit by non-voters Mester and Williams – could firm up expectations for the 2H17 policy sequencing of a start to the balance sheet run-off in September and a December rate hike.

EUR/USD

Second quarter Eurozone GDP was in line with consensus at 0.6%, although the first quarter number was revised down to 0.5% QoQ. As our Eurozone economists note, the region seems to be set up nicely for continued firm growth for the rest of 2017, which is likely to keep the markets' current ECB QE taper bias in place. EUR/USD uptrend remains intact, though we would expect some consolidation around 1.18 ahead of Friday's nonfarm payrolls jobs' report.

GBP/USD

With sterling going into the August Bank of England 'Super Thursday' meeting on a mildly bullish high, we think the downside risks from an on-hold MPC – with a 6-2 vote split – are much higher. The latest manufacturing PMI reading is likely to have fuelled lingering hopes of a hawkish BoE surprise tomorrow and a firm construction PMI release today could do the same. But in the absence of these figures spurring a sudden wave of optimism within the MPC, we struggle to see the Bank following through with a surprise hike tomorrow. Admittedly, it would be 'sentimental' were the Bank to reverse its post-Brexit 25bp rate cut exactly one year-on – but a 'one-and-done' message wouldn't actually drive GBP much higher from these levels. We would expect GBP/USD to top out around 1.34 (next key resistance at 1.3280).