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Article

USD: Secret admirers return

Investors are still showing love for the dollar, possibly front-running the US outperformance story

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USD: A little more love shown to the dollar

It's hard to put a finger on what's driving this short term demand for the dollar. The latest buy-side surveys show investors remain very overweight (presumably USD) cash and despite fears of secular stagnation, equities are largely holding onto gains made in 2019. True, we've seen an unrelenting run of bad activity data out of Europe and one of the market's early year favourites – the South African rand – has handed back two-thirds of its gains, but the FX market seems to be front-running the US outperformance story. For example, decent US activity data has yet to rekindle Federal Reserve tightening fears this year, yet the dollar is still climbing. We do like the dollar higher against the low yielders in Europe and Japan, but still feel there are opportunities in undervalued emerging markets. For today, we should see a decent US retail sales figure for December, and reports that Donald Trump is preparing to extend the 1 March deadline for increased Chinese tariffs by 60 days should be generally positive for risk - assuming the soft set of 4Q18 GDP readings in Western Europe can be absorbed. DXY to target 97.70 highs.

EUR: Peak pessimism? Perhaps not

A very bad run of European data should be crystalised today in the 4Q18 GDP releases. Germany has already produced a poor unchanged quarterly reading and eurozone GDP should be confirmed at a meagre 0.2% QoQ. Add in risks of a new Spanish election and the threat of US tariffs on the auto sector (report due by Sunday) and the European story is not attractive at all. However, there is a huge divergence between EUR/USD and short term rate spreads, suggesting that the 1.1220/1270 support area for EUR/USD will be difficult to break.

GBP: More focus on 27 Feb vote, rather than today's

Today's vote in parliament could prove a mild negative for sterling if news of another defeat to Prime Minister Theresa May were to emerge. This vote is really on whether parliament backs May's negotiating stance, but a defeat would likely mean little. The main event in parliament looks to be 27 Feb, where we could see the Cooper-Boles amendment resurface, paving the way for a nine-month delay to Article 50. 1.2830 support in cable is at risk today.

RUB: Return of the sanctions threat

Despite firmer energy prices, the rouble has also followed the emerging markets FX complex lower over the last 48 hours – probably linked to the return of the US sanctions threat. The very aggressive DASKA sanctions bill was re-introduced into US Congress on Wednesday which, amongst other things, would sanction participation in new sovereign debt issues. As Dmitry Dolgin highlighted in his 2019 Russia outlook, Non-Residents had cut their holdings of OFZs to below $30 billion late last year and based on the evidence in 2014, foreigners could cut those positions by 30%. He estimates that every $5 billion of outflows could raise USD/RUB fair value by one big figure. What we would say is that with an implied 3-month yield of 7.6%, the rouble is an expensive sell. And given the uncertain progress of this bill it looks too early for big changes to our USD/RUB forecasts of near 65.

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