Dollar digs in

The outlook for Asian currencies is in large part a function of the strength of the USD, and the US currency shows few signs that it is willing to capitulate.

No help for Asian FX from the EUR

Our house view on EUR/USD from our FX team has been bullish all year, and if memory serves me right, from 2017 too, with a 1.30 end-2019 forecast. As a directional call, there is much to be said for it, though even they would probably concede that the magnitude can be a tough sell at times.

Scope for a break out in the direction of our house call was looking promising at the end of last week and would have taken some of the pressure off our Asian FX pairs, which have been battered since 2Q18 on a mixture of dollar strength and EM weakness. Both these pressures were showing signs of abating recently, allowing perhaps for some retracement.

But for the USD to really weaken, part of the story had to include a stronger EUR. That part has been dealt a blow by the Italian government budget proposal of a 2.4% deficit. 2.4% may not sound like much, and it is within the Maastricht deficit limit of 3.0%. But against a backdrop of public debt that exceeds 130% of GDP and a real growth rate that has exceeded 2.4% only very briefly and fleetingly since 2000, 2.4% appears unsustainable and could set the Italian government up for a row with the EU commission. For much more on this and the somewhat disappointing recent growth performance of the Eurozone, our Eurozone team's latest quarterly should answer all your questions, and more.

It's EUR weakness, not USD strength

The Italian budget decision has weighed heavily on the EUR, which from about 1.18 earlier in the week, has pushed down through its 100-day moving average and is now somewhere around 1.1635. This really is a surprisingly strong turnaround in fortunes and indicates how weak the recent EUR up-move may have been.

Fortunately, so far this hasn't filtered through into any Asian FX weakness, so we can perhaps view this move primarily as EUR weakness, not dollar strength. This is a far less negative story for the Asian region. Though we may also want to factor in the helpful actions by BI (Bank Indonesia) and BSP (Philippine Central Bank) central banks yesterday, both of which lived up to expectations in hiking policy rates. Next Friday sees the RBI (Reserve Bank of India) probably following suit...

Oil really not helping the more challenged parts of Asia

We were hoping that the resurfacing of commentary on the EU, Russia and China's special purpose vehicle (SPV) for resuming oil trade with Iran, might take the pressure off crude oil prices. The absence of Iran from global oil supply seems to be the single biggest factor pushing prices higher than our commodity analysts have been expecting, though logistical bottlenecks from US shale output will also not have helped.

As well as pushing inflation higher in economies such as the Philippines, higher crude oil is also providing an unhelpful negative push to regional trade balances, Indonesia and India for example. Coupled with a softer dollar (as mentioned - still largely elusive) lower crude prices could quickly change the Asian backdrop to a far more positive one - which would be very welcome given the fact that the negative impacts of the US-China trade war are becoming somewhat clearer in the data, and could spill over into other countries in the region.

So far though, chat is all that this appears to be, and it is not obvious that this SPV will deliver a practical alternative for countries wanting to circumvent US trade restrictions. Were this to change, so too could crude benchmarks, which might come much closer to our end of year $75/bbl forecast (Brent).

Asia Day ahead

A slew of Japanese data has already filled the data screens, with perhaps the most eye-catching, being the above expectations Tokyo September CPI figures - these now showing inflation in the capital at 1.3% (up from 1.2%). Where Tokyo CPI goes, the national figures almost always follow, and in any case, a combination of energy price rises, and weather-induced food price spikes was likely to push national inflation rates further above 1.0% (currently 1.3%), providing more cover for the BoJ to conduct its stealth tapering.

In this vein, there is quite a lot of talk about cuts to the BoJ's regular super-long asset purchases, and maybe a reduction in the number of their monthly operations too. If so, this could result in some JPY strength - JPY currently looking quite soft at 113.38.

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