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FX

2019 FX Outlook: Peak Dollar

The big question for 2019 is when will global asset markets be released from the stranglehold of high US interest rates and the strong dollar? We think it's too early to be positioning for a turnaround just yet, however, the dollar is significantly overvalued against most currencies, suggesting any new highs are likely to be marginal



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Executive summary

It's too early to call a top in the dollar. The Federal Reserve is now in the realms of late cycle tightening and should deliver four more hikes. Dollar hedging costs will remain extremely expensive and, barring a US-centric shock; we expect to see marginal new dollar highs against the EUR and the JPY over the next six months.

As 2019 progresses, expect a bearish dollar narrative to develop. US rates should be

coming off their highs by the end of the year and as US growth converges lower to the rest of the world, expect investors to rotate out of US asset markets. A search for alternative sources of stimulus may also see the White House favour a weaker dollar.

Europe has been a big disappointment in 2018. Though sluggish growth has been blamed on a relentless stream of 'one-off factors', it is hard to see a significant pick-up in activity next year. EUR/USD will struggle to make it above 1.20, as the ECB barely lifts rates off the floor. European Parliamentary elections in May will also be in focus.

A lower EUR/USD in the early part of the year is typically not good news for CE4 currencies. The good news is that the Hungarian forint and the Polish zloty are already undervalued, while the market's favourite villain – the Romanian leu – is too expensive to sell. Any Czech koruna gains should be primarily dependent on the hawkish Czech central bank, not EUR/USD.

On Brexit, UK parliamentary approval of the Withdrawal Agreement may not be seen until February. Even if the deal is passed, 2019 is unlikely to look pretty either as both the UK and the EU struggle to define what the ultimate relationship should look like. Expect the pound to continue to trade on volatility levels more common in emerging markets.

For EM, the gales blowing out of the US look set to continue through early 2019. Add in declining world trade volumes, and rising late cycle volatility and the EM environment looks challenged. But EM currencies have already discounted a lot of bad news. If they can survive the first half, modest rallies should be seen later in the year.

Within the EM space, we see the Renminbi steadily weakening all year as the economy adjusts to the US trade agenda. Our USD/CNY target is 7.30. In theory, a softer environment for crude oil prices in 2019 – we see Brent trading more in the USD60/bbl area than the USD70/bbl area – should be good for Asia. Assuming the Indian rupee can survive elections in May, central bank tightening in 2H19 should allow the currency to take advantage of the softer dollar story.

The big beasts of Latam – the Brazilian real and the Mexican peso, will continue to see substantial volatility as investors adjust to the new political reality. Argentina aside, better external accounts, low inflation and faster GDP growth suggest more resilience in the region. However, Brazil's ability to pass fiscal legislation will very much set the tone early next year.

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