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FX TALKING

FX Talking: ‘Opportunistic reflation’ sinks the dollar

Much discussed in financial markets this summer is the drop in US real yields as the Fed keeps rates low, while US inflation expectations are on the rise. Expect this macro-policy theme to play a major role in FX market pricing ahead of a possible Fed adoption of an average inflation target in September. This theme is a broad dollar negative



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Executive summary

For EUR/USD, that means we bring forward our 1.20 year-end target to 3Q20 and see scope to 1.25, especially were global equity investors to execute on plans to rotate into European equities. Also participating in appreciation against the dollar should be the JPY and CHF, although both nations will try to slow the rally.

Commodity FX should continue to perform well in a reflationary environment. Inevitably there may be some short, sharp corrections after what have been some hefty gains, yet the reflation story looks to have legs. Elsewhere in G10, we doubt GBP holds onto recent gains – even though investors are very underweight.

In the EM space, we prefer the CE3 currencies. These are enjoying riding on the back of

the EUR/USD rally as well the direct budgetary benefits of the newly agreed EU Recovery Fund. We prefer BRL in the Latam space and in Asia see cautious gains, although these could be easily undone if we are underestimating how aggressively President Trump will target China ahead of 3 November.

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