G5 currencies at a crossroads

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The year started with a fairly bearish response of the USD against most of the G5 currencies and thereafter the greenback has consolidated within a certain range against most majors. Below we take a quick look as to what to look forward to and what to watch out for.

EUR €

There have been a number of important events that have taken place in Europe and in the US.

Political Developments

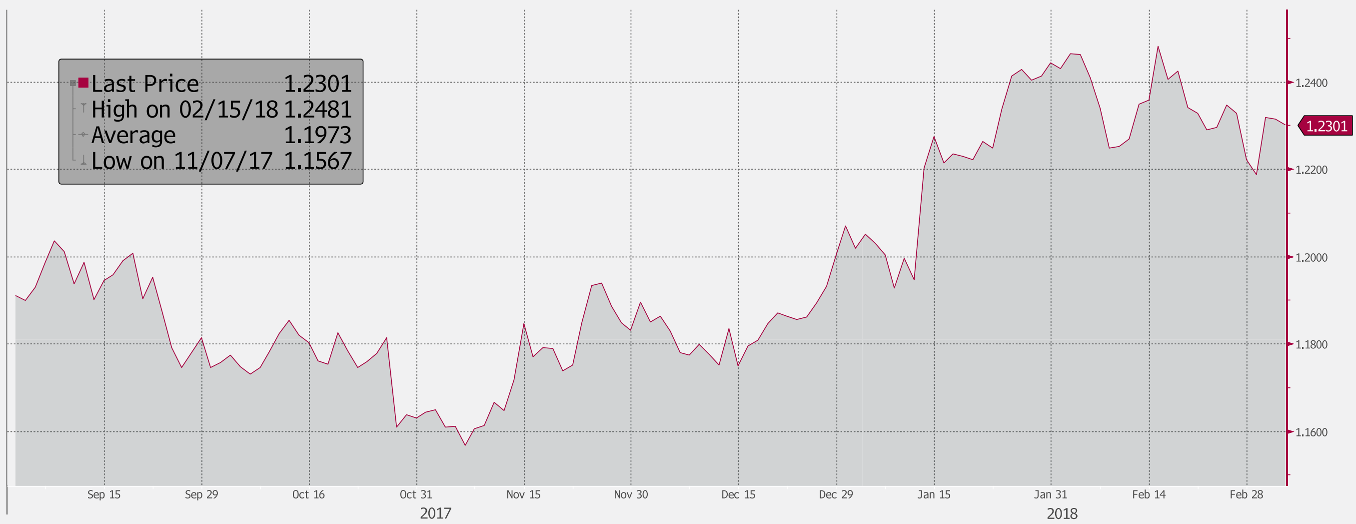
Starting with Europe, Germany is finally moving ahead with the formation of a strong coalition government under Merkel, to the delight of the Eurozone and French President Macron's agenda for further European integration – a definite sign of stability for the Euro.

Second, the Italian elections that just took place, only confirmed the pattern seen in the months leading up to and the aftermath of last year's Dutch, French and German elections: prior to the elections there was significant concern of anti-establishment parties strengthening which could potentially harm the cohesion of the EU and the Euro in particular. Once the elections were concluded, such concerns were laid to rest, when more traditional pro-Europe forces prevailed.

For Italy specifically, although the anti-establishment parties strengthened, the leaders of both the Five Star movement and the League had toned down their pre-election statements regarding leaving the Euro. In the near term we may indeed see a small correction lower for the Euro, given the anti-migration policies and non-conventional style of decision making advocated by the parties that have gotten the most votes in Italy's hung parliament. However, the medium term outlook from the election result is a Euro stable to positive signal, albeit much priced in, in the last one month leading up to the Italian elections.

Economic developments

And then there is the big unknown: one of the major reasons that halted Euro's sharp rise from 1.1850 to 1.2500 over the last 2 months was the uncertainty around the ECB's message coming out of its Governing Council next meeting on March 8th. Heavily dependent on data releases, it seems that Draghi may actually exercise more caution when delivering his statement. At the moment, the data coming out from Europe is conflicting: Yes, growth has been evidenced. However,



EUR/USD 6 months historical prices. Source: Bloomberg.

the link between core inflation, unemployment and wage growth is to blame for this conflict: core inflation has failed to pick up, despite the drop of euro area unemployment rate to 8.7%, the lowest since 2009. While falling unemployment should help boost consumption, thereby contributing further to the self-sustaining character of the recovery, the key question for the ECB is when the low unemployment level will start to push wages higher. In fact, data indicates a shortage of personnel needed to avoid production bottlenecks, reinforcing the point that wage growth should have already started to pick up – but alas it hasn't, not enough anyway.

On the currency strength front, during the last ECB meeting, Draghi mentioned twice that the appreciation of the EUR is a potential risk for growth, and the market apart for a brief correction, shrugged off the comments. As we draw closer to the next meeting, Draghi may try to sound more cautious: He could very well reiterate that the Euro's strength can partially curb Eurozone growth: Such an effect would deviate from the positive tone that the market has come to expect from the tapering of the quantitative easing of the ECB, in line with ECB's belief the market has slowly turned around. Testament to that anxiety is the fact that in the last few weeks we have seen a surge of market participants buying protection in the FX Options market against EUR falling which would affect the value of any assets they hold denominated in Euro.

On the other side of the pond, we have a very interesting mix of developments: Unemployment in the US is at the lowest level for a decade, interest rate hike trajectory is positive and after the last FED meeting even accelerating. On the legislative front, the tax bill was recently passed signifying tax cuts which most US companies viewed as positive. All of the above are occurring at a time that the USD remains weak, which could attract significant repatriation of investments into the US.

To balance these out however, one should keep in mind the looming threat of the US pull out of NAFTA, which the latest announcements from Trump for the imposition of tariffs on steel and aluminium imports brings to the forefront. Such a potential pull-out could force of course negotiations between US, Canada and Mexico for an altogether new Trade Agreement. What is certain is that should the US decide to leave NAFTA, this would lead to additional wide spread tariffs imposed on goods traded in the region, increased prices for goods and a potential drop in company profits. This could in turn feed back into the US economy in the form of a deceleration in growth, loss of jobs and higher inflation due to the tariff-led price increases. Any tariffs imposed will have an effect against all trading partners of the US, including retaliatory tariffs by them.

Technical overview

In light of the above developments in the Eurozone and the US, there seem to be enough forces at play to suggest EUR/USD having more of a range bound trajectory in the next couple of months, with an upward bias, in the range of 1.2250 to 1.2750. In fact there could be a small pullback lower towards the 1.2100 level before the EUR surges higher than 1.2500 again. Again, the direction seems to be heavily dependent on event risk, rather than sound macroeconomic developments.

GBP £

Political Developments

Movements in the **GBP/USD** and **EUR/GBP** are without surprise dominated by the on-going and ever evolving Brexit theme. Markets were eagerly awaiting British PM's speech last Friday to provide clarity as to the way forward in Brexit negotiations: On paper, Theresa May provided just that: She wants a bespoke trade deal with the EU for Britain. The tone of the speech was one of reconciliation and pragmatism, to quote her "no side can get an agreement exactly the way they want it". While this resonated positively with most of the hard Brexiters and pro-Europe MPs within her own Conservative Party, it failed to impress the Europeans: They label her approach "cherry-picking" and they were quick to remind everyone that what May proposed, the Europeans have already rejected in the past. The stark reality is that the speech did not offer any new perspective as to the way forward. In addition, the heat on the border issue of Northern Ireland has once again intensified, given the lack of agreement between EU and Britain on a trade agreement.

Economic developments

Meanwhile, on the data front, the rise of UK's unemployment rate to 4.4%, seems to be creating headwinds for the GBP, despite UK wages figure remaining unchanged at 2.5%. This can re-ignite the "Brexodus" theme, now that unemployment figures are rising: Reports published show a substantial drop in job vacancies in financial services in London – more than

37%, with jobs shifting overseas. All of the above are on the back of a GBP appreciation close to 10% against the USD in 2017.

Furthermore, the Bank of England seems poised to raise interest rates twice this year, with the first hike most likely to take place in May 2018. This could start to bite in the housing market and house prices, as despite mortgage rates still being at historical low levels, the UK houses prices are still at rather high levels.

Technical overview

Given the headwinds ahead, it would be fair to say there is little room for further appreciation of the GBP. At the same time, data on non-commercial futures shows that the market has not over-bought the GBP, which precludes a massive correction lower. Hence sideways movement for the GBP/USD in a range of 1.3500 to 1.3950 is to be expected for the next few weeks, with a slight bias to the downside.

Last but not least, the on-going conundrum in the Brexit negotiations, is favouring the EUR more than the GBP, with the EUR/GBP pair currently trading at a high of 0.8930, and exhibiting a neutral to higher propensity for the next few weeks, with the psychological level of 0.9000 being just around the corner.

GBP/USD 6 months historical prices. Source: Bloomberg.

CHF ₣

Political Developments

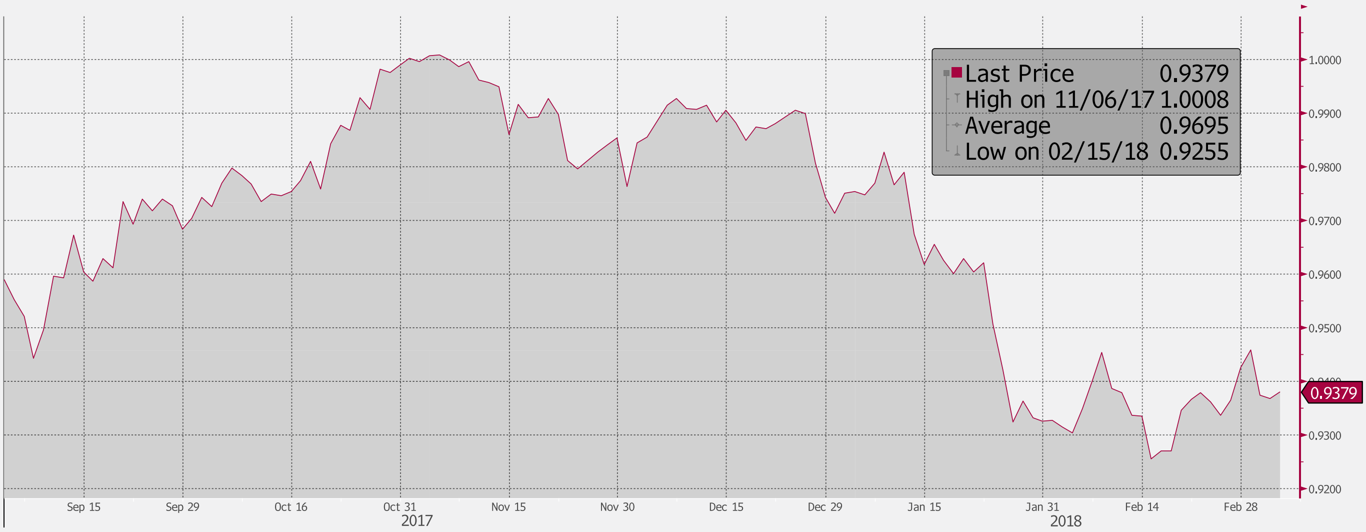
The CHF has not been affected by any domestic political developments or by the country's traditional neutral stance in the international political arena.

Economic developments

It has been fairly quiet on the economic news and data releases front for Switzerland in the last few weeks. Most currency moves for the CHF are due to external movements of its major trading currency partners, USD and EUR.

Technical Overview

The USD tested last week higher against the CHF at 0.9490, when USD was trading higher against most G10 currencies, but failed to sustain the levels and dropped sharply since then, currently trading at 0.9370. Should the USD fall further against the CHF, the next minor support level is at 0.9320, and should we break below this, the CHF could strengthen potentially all the way to 0.9186. However, in the next week, USD/CHF is expected to trade in a more neutral stance around present levels, as there are no Swiss specific economic data expected. Any move outside the wider range of 0.9320 to 0.9490 is more likely to be caused by a resurgence of the Euro against the USD, which can affect the cross of EUR/CHF. The latter is trading steadily in the range of 1.1500 – 1.1600 since end of January when the pair corrected sharply down from 1.1800.



USD/CHF 6 months historical prices. Source: Bloomberg.

JPY ¥

Political Developments

The latest announcements by the US President of potential imposition of protectionist type of tariffs has weighed down on the USD and helped the JPY re-assume safe haven status, with substantial increased demand for JPY. It has had the opposite effect however on Japanese stocks.

Economic developments

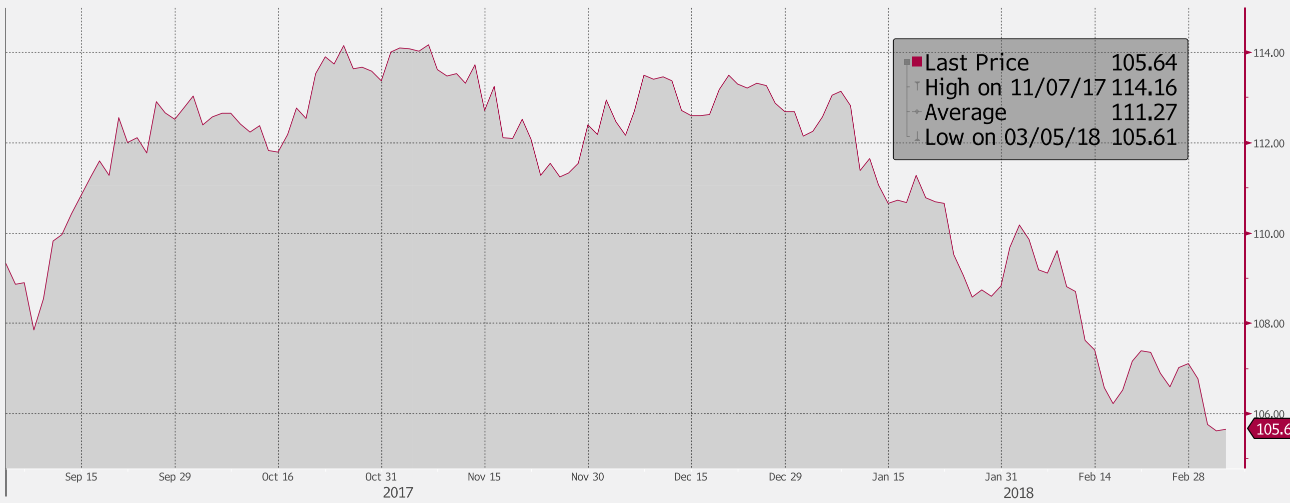
The JPY is currently trading at four months highs against the USD at 105.45, benefitting from a reviving safe-haven demand for the currency, amid fears of a looming trade war. We should keep in mind that the JPY has been strengthening for some time already. Hence, we could potentially see some consolidation ahead of the 105.00 psychological level, with some USD buying interest coming back to the forefront.

On the other hand, the Bank of Japan's governor Haruhiko Kuroda's statements acknowledging the possibility of a stimulus exit for his country, kept the pressure on for JPY to appreciate further against the USD.

Last but not least, as the fiscal year for Japan starts in April, it is important to remember that typically March is a month where Japanese companies are net buyers of JPY as they repatriate assets, a factor that typically pushes the JPY little higher.

Technical Overview

Should JPY break below 105.00, we would be looking at a gradual move towards 101.00. If the fears of a trade war are somewhat abated or toned down, we could potentially see a correction higher towards 108.90. In the next couple of weeks it would make sense to observe a trading range of 104.00 to 107.00.



USD/JPY 6 months historical prices. Source: Bloomberg.

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