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FCM Bank Currency Outlook

MONTH OF MARCH

OVERVIEW

Delay was the motto for currency markets in February. A Delay in the US-China Trade War deadline left markets more positive about a solution, but has prolonged the uncertainty. In the UK multiple delays of the meaningful votes on Brexit ultimately saw the GBP rally as markets priced out the possibility of a “No Deal” Brexit, but provided no more clarity on the final outcome.

The delays in political events and a slowdown in Fed related volatility allowed markets to pay more attention to economic data than had been the case in January. The US economy remained strong and further cracks in European economic data pulled the EUR/USD to the lowest levels since November. UK economic data was disappointing, though markets had largely priced this in.

March will offer more uncertainty with the biggest volatility in major currency markets expected to be in the GBP as we see the British Parliament finally forced in to making a decision on Brexit next steps. The March 29 deadline for the UK to sign a deal with the EU or request an extension to Article 50 means that Theresa May will finally be forced to hold a meaningful vote. In Europe markets will look to see if cracks in the manufacturing sector and the German economy worsen; while in the US markets will assess whether Fed dialogue becomes less dovish considering more resilient than expected GDP growth and inflation readings.

WHAT TO WATCH OUT FOR IN MARCH

USD – PUSHING FOR NEW HIGHS AGAINST THE EURO

The USD strengthened throughout the first half of the month buoyed by the stronger than expected jobs numbers and manufacturing data that kicked off February. The dollar quickly erased the losses of late January posting 6 straight daily gains against the Euro pushing the dollar to the psychologically important 1.1260-1.1270 region that has provided consistent support since November. Over the following days the dollar repeatedly attempted to break below the support levels but any gains were short lived setting up a retracement that saw EUR/USD mean-revert back towards 1.14. Markets will look for a sustained break below 1.1260 as a catalyst for further gains. A move above 1.1430 would confirm a trend reversal and leave room for a push back to recent highs above the 1.15 psychological level.

GBP – BREXIT DELAYS ADD TO UNCERTAINTY FOR MARCH

Theresa May continued to wind down the clock on Brexit. Twice in February she delayed meaningful Brexit votes which were expected to provide direction to the GBP. This resulted in one of the least volatile periods for the GBP in recent times as the lack of any new information left market pricing largely unchanged. Late in the month, though, May announced a series of votes. One for her Brexit deal on the 12th, one on the possibility of a “No Deal” Brexit on the 13th, and a vote on extending the Brexit date past March 29 which will be held on the 14th. This saw a strong rally in the Sterling at the end of the month as markets rejoiced in the likelihood parliament will be able to rule out a catastrophic “No Deal” Brexit. This pushed the GBP to the highest levels against the Euro since May 2017. In March expect volatility to intensify as “Headline Risk” heightens as one news item or political vote has the ability to change the UK’s economic destiny.

EUR – WEAKENING DATA WEIGHING ON THE EURO

The Euro weakened significantly against its major trading partners in February. Slightly better than expected core inflation readings gave the Euro a little bounce at the start of the month but these small gains were immediately reversed as producer price data showed a 0.8% month on month decline. Investor confidence data showed the weakest levels since 2014 exasperating a tailspin that would see the Euro trade to the lowest level against the dollar since November. There was a recovery late in the month but this was largely inspired by USD weakness as risk on sentiment emerged.

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USD OUTLOOK MARCH

Politically a de-escalation in the government shutdown tensions appeased markets and perceived progress on US China Trade talks left markets with a slightly more positive outlook for US economic growth in 2019. Gains in the dollar, however, have been limited by the Greenback's status as a safe haven currency which sees funds flow out of USD denominated assets towards higher yielding riskier assets in the wake of good news. The decision by President Trump to back away from his threat of further tariff escalation in March provided one such example where the good news sparked a risk on rally that hampered the dollar, despite the positive implications for the US economy.

On the data front the labour market remained strong with the closely watched NonFarm Payrolls Report on the 1st of the month showing 304,000 new jobs, almost double the anticipated 165,000. Fed chair Jerome Powell has repeatedly pointed to the tight labour market as a positive for inflationary expectations with wage growth of consistently over 3% having a delayed effect on inflation of approximately three quarters.

Inflation remained robust with the Fed's preferred measure of "Core Inflation" which cuts out volatile food and energy prices remaining solid at 2.2%. While inflation is not currently a concern for the Fed at these levels, many observers had been predicting inflation to decline, giving the Fed more leeway to be patient in their monetary policy. If this does not play out markets may need to change their expectations for a Fed on hold throughout 2019 which would support the USD.

GDP data released on the last day of February showed Q4 growth of 2.6% which beat market expectations significantly and contributed to a 50 point reversal late in the trading day, possibly setting up a further USD rally as we look to the start of March.

In March attention will shift back to the Federal Reserve with the all important Fed Interest Rate Decision and associated statement to be released on the 20th. While markets are not anticipating any change to the target Fed-Funds Rate, the statement will be closely analysed for any changes. Markets are currently not pricing in any hikes this year while a recent Reuters poll of economists show most economists predict at least one. If the markets are under-pricing this likelihood we could see a knee-jerk rally in the USD on the 20th if the Fed surprise with a more hawkish forecast. Either way expect volatility around the announcement.

KEY DATES FOR THE USD IN MARCH

FRIDAY 1ST
Manufacturing Purchasing Manager's Indexes

FRIDAY 8TH
NonFarm Payrolls and Wage Growth

TUESDAY 12TH
CPI Inflation and Core Inflation

WEDNESDAY 20TH
Federal Reserve Interest Rate Decision

THURSDAY 28ND
Final Q4 GDP

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GBP OUTLOOK MARCH

In February the GBP peaked to the strongest levels against the Euro since May of 2017. The looming Brexit deadline failed to inspire the expected volatility in February as meaningful parliamentary votes were pushed to March. The series of postponements were architected by Theresa May in an effort to force other politicians in to supporting her withdrawal deal with the EU.

While the UK House of Commons had requested binding changes to the Norther Irish Backstop, top European diplomats have repeatedly ruled out any hope or reopening the agreement that took almost 2 years to design. The Northern Irish Backstop is unpopular as it keeps the UK tied to the EU Customs Union pending an alternative arrangement, which many fear could leave the UK permanently tied to EU trade rules. It is, however, one of the few arrangements possible to avoid a hard border between Ireland and Northern Ireland which is vital for the ongoing peace process. The Democratic Unionist Party, a Northern Irish party that hold the balance of power in parliament have refused to support any deal containing a backstop as they fear it could lead to Northern Ireland being treated differently to the rest of the UK. Old political controversies are at the heart of the current debate, flaring up hatred on both sides and further muddying the unclear future of the EU-UK relationship.

For the GBP, the end result will vary drastically depending on the political outcomes in March. Should Theresa May's deal get through parliament on the 12th the GBP is expected to rally sharply as businesses receive the certainty they have been missing for the last 2 years.

If her deal does not pass the most likely outcome is a request to extend Article 50, effectively the legislation that set March 29 as the date the UK will leave Europe. This outcome could support the GBP as it makes a closer relationship with the EU more likely and leaves open the possibility of a 2nd referendum and the UK staying in the EU.

The request, however, would need to be approved by all 29 member states of the EU, something a number of European officials have said they would not entertain without a clear plan as to what the extension would be used for. Considering the factional nature of the British parliament a consensus on a clear plan for what an extension would be used for is highly unlikely, leaving more uncertainty. Depending on the EU response to an extension request the UK could be forced in to a last minute vote between a disastrous "No Deal" Brexit, and Theresa May's unpopular withdrawal deal. The volatility around such a dramatic climax would bring significant risks and opportunities to GBP buyers and sellers and should be carefully considered by those with GBP exposure. Though the probability of a "No Deal" Brexit is very slim, expect the GBP to sell off aggressively if this becomes more likely.

On the 21st of the month markets will assess any Bank of England response to the uncertainty to see how monetary policy is likely to evolve after political developments in the first half of March.

KEY DATES FOR THE GBP IN MARCH

TUESDAY 12TH
Vote on Theresa May's Deal

WEDNESDAY 13TH
Vote on No Deal Brexit

THURSDAY 14TH
Vote on Brexit Extension

TUESDAY 19TH
Unemployment and Earnings Growth

THURSDAY 21ST
BOE Interest Rate Decision

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EUR OUTLOOK MARCH

The big news in Europe didn't come from European data as a whole but from the softening of the Eurozone's largest economy. German Industrial Output, Factory Orders and Manufacturing confidence surveys all disappointed markets, contracting steeply. Previous talk of a slowdown in Germany moved to talk of a recession. German primary industry strength is important as a large part of the Central European economy operates as a supply chain for German factories. This means that as German manufacturing weakens the demand for many other goods produced in other European economies also slows, having a delayed knock on effect to the European economy as a whole.

Mario Draghi, the head of the European Central Bank, was notably quiet on monetary policy in February. This raises the importance of the March 7 ECB meeting. Markets will watch closely for signs of the willingness of the ECB to assist the weakening European economy. While markets aren't pricing in any policy easing just yet, any comments that imply assistance is going to be forthcoming could weigh on the Euro. The rate hike which was expected later this year has been priced out with markets now expecting this in mid-2020, the ECB is likely to confirm this view.

Rate guidance, however, is not the only focus of the meeting. The market will look to the ECBs balance sheet manipulation as a more likely source of support. The ECB's bond buying program has been halted, whether they back-track and announce further bond purchases, which inject money in to the economy, will be the question on everyone's lips. With the economy slowing and rates in negative territory, the most likely way for the ECB to stimulate the economy is with further quantitative easing, which would weigh on the Euro. Expect any commentary from Draghi and other officials about this to create volatility.

Markets have become increasingly pessimistic over the outlook for European growth. This brings with it the chance that we could get surprises on the upside. Geopolitical risks like the China-US Trade war and Brexit are hurting confidence in business investment. With outcomes expected soon from both of these risk factors there is potential for the European economy to recover, or at least halt its deterioration should these events turn out positively.

We have to be conscious too that against a number of the Euro's trading partners we are trading at historically weak levels, leaving questions as to whether the Euro is undervalued. Should we see an improvement in data, this would allow the shared currency to move higher with less fear of overshooting than if we were at historically strong levels.

In March the tone from the ECB, German industrial output, and Manufacturing data in Europe as a whole will all be closely watched. Fears of a European recession are being stoked by decreasing output so a rebound in this data would help the Euro recover.

KEY DATES FOR THE EUR IN MARCH

FRIDAY 1ST
CPI Inflation (February)

MONDAY 11TH
German Industrial Production

THURSDAY 7TH
GDP and ECB Rate Decision

FRIDAY 22ST
German and European Manufacturing PMI

FRIDAY 29ST
CPI Inflation (March)

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OTHER CURRENCY TRENDS

The Japanese Yen weakened throughout February. The risk on sentiment fuelled by a more positive outlook for US-China trade talks fuelled a depreciation in the risk averse currency. The US stock market also continued its recovery leading to flows away from safer assets. The Swiss Franc followed suit though not as much as the Yen.

Stimulus from the Bank of Japan is ongoing, with an unparalleled expansion in the balance sheet. Asset purchases, payed for with printed money, inject money in to the economy in an attempt to increase stubbornly low inflation and stimulate growth. The injection of further currency into circulation ultimately leaves the currency prone to weakening. The Bank of Japan has not indicated any plans to halt asset purchases. The Yen is a proxy for risk appetite so any change in risk sentiment caused by for instance a No Deal Brexit or a resumption of trade hostilities would see the Yen strengthen quickly. Yen buyers will be hoping for a positive resolution to trade talks in March as the impact on risk sentiment would make the Yen cheaper.

The AUD, CAD and NZD had a rather turbulent month, all three struggling for direction. Despite a more positive outlook for trade, Chinese growth concerns continue to hamper the export dependant nations. This brought a number of analysts and banks to downgrade growth outlooks and bring up the potential for more dovish monetary policy. In commodity markets oil rallied in the middle of the month, helping the CAD to recover. Iron ore peaked and then retraced, offering no further support to the Aussie.

In Switzerland the strength of the CHF has been leaving the SNB to repeatedly comment that the franc is “highly valued”, a danger to the Swiss economy which would be exasperated by any tightening in monetary policy. Persistently low inflation is furthering the problem leaving no room for the Swiss National Bank to increase rates from the super-accommodative -0.75% they have been stuck at since the beginning of 2015. Expect the CHF to strengthen further if we see global risks emerge, despite what the SNB may be able to do to halt its appreciation.

In northern Europe, the Norges Bank is set to be the only large central bank to raise rates in the first quarter of 2019. A robust economic outlook and wage growth, along with inflation above target is allowing the Norges Bank the freedom to normalise monetary policy that is the envy of the rest of Europe. While the hike is largely priced in, expect further strength in the Norwegian economy to support the NOK as markets look to further hikes later in the year.

The Riksbank in Sweden is not enjoying the same inflationary pressure, putting their forecast hike in the second half of this year under scrutiny. Expect any pull away from a hiking bias by the Riksbank to further hurt the SEK which has remained under pressure all year. A downward revision in interest rate forecasts would not be unusual; they have downgraded 10 times since 2015.

Written by Jonty Blundell, Director of Dealing, FCM Bank Limited 01/03/2019

KEY DATES FOR OTHER CURRENCIES IN MARCH

TUESDAY 12ST
Reserve Bank of Australia Interest Rate Decision

FRIDAY 15TH
Bank of Japan Monetary Policy Statement

WEDNESDAY 6TH
Bank of Canada Interest Rate Decision

THURSDAY 21ST
Swiss National Bank Interest Rate Decision

TUESDAY 26ST
Reserve Bank of New Zealand Interest Rate Decision