CURRENCIES

Geopolitical risks will continue to play a key role

The essential

Central banks' ongoing policy normalisation, trade tensions and political issues will be the key drivers to watch in the FX market. Brexit and political noise in the Eurozone might weigh on GBP and EUR for some time. We expect the USD to remain strong in the short term, and weaken with a medium-term horizon as in addition to other factors, the economy might reach the mature phase of its cycle, a situation that has historically coincided with a weaker US dollar.

EUR/USD: short-term headwinds, more positive medium-term outlook

FX target for Dec 2019	
	Target range
EUR/USD	1.23-1.25
USD/JPY	105-107
GBP/USD	1.39-1.42

Data as at 15 October 2018

Diverging financial conditions with respect to the US, mild (albeit increasing) growth, concerns over the impact of a trade war on European exports and rising political risks have weighed on the EUR during the year. More recently, headwinds from the Italian budget announcement put a cap on the EUR in light of the many uncertainties that remain and might be in place for some time to come as, for instance, negotiations with the EU Commission might take a while to reach a resolution. With the renewed rise in German political uncertainties and with Italian political risks tilted to the upside, we could see some short-term pressures that could prevent the EUR/USD from appreciating from current levels. European elections also pose additional risks to the currency – as the Bavarian elections recently showed, increased political fragmentation may be expected in addition to the risks of breakthrough of populists. Despite the fragile sentiment, elevated speculative short positioning indicates the negatives are very much priced in and, thus, further EUR selling seems unlikely, especially in the context of strong fundamentals. While growth for the Eurozone should remain above potential, external sector figures are also supportive to the currency (very high current account surplus). Moreover, we expect the ECB to keep moving towards normalisation and increase interest rates in H2 2019, thus lowering the policy divergence with the Fed. Hence, we remain EUR bullish in the medium term.

USD/JPY: downward trend for the year ahead

While we believe the USD/JPY might keep trading around the current levels (our forecast is 112 by the year-end), we expect the Japanese yen to be on an upward trend in 2019, driven by monetary policy and persistent trade protectionism talks. While recent communication from the Bank of Japan (BoJ) points to the continuation of the ongoing ultra-accommodative monetary policy for some time to come, we expect the BoJ to allow further flexibility on its long-term yield policy next year, thus moving (albeit at a very gradual pace) towards the normalisation of its monetary policy stance. Moreover, global trade friction risks might persist or could further escalate in the medium term. This provides further support to the currency, due to its traditional safe haven status. Its extremely cheap valuation (the lowest among the G10 space) and the resumption of a medium-term USD downtrend could also provide support for the currency's appreciation. In addition, past experience has shown that the JPY tends to appreciate further on the back of rising US bond volatility, due to the effect of positions rebalancing and capital repatriation back to Japan. We note that hedge ratios on Japanese investments in US assets have indeed decreased substantially due to the high cost of hedging and any repatriation is not likely to be FX neutral.

GBP/USD: it is all about politics

Brexit negotiations are entering a critical period and, as such, the pound has reacted to political developments. As many uncertainties remain over the future of the British economy, we expect the currency volatility to remain high in the short/middle run. Even though in our baseline scenario (70% probability): i) the UK and the EU will reach a deal late in 2018 or early in 2019; and ii) the UK is going to exit the EU in March 2019 or soon afterwards to start a transition period, we expect that such a deal will only be reached through a "rock path". This means that initial deadlines are mostly likely to be bypassed, the deal is likely going to be reached at the last moment and the parliamentary approval process is going to be very difficult. But we note that this is something that seems to be very much priced in as investors remain short the currency and option market participants remain tilted to the downside, even looking at a 1Y time horizon. Thus, we expect temporary market stress regarding Brexit would certainly give some relief to the currency. In our view, the potential upside should remain quite contained as markets might start looking at the country's ability to finance its large current account deficit under the new framework, thus putting a cap on the GBP. We also note that support from monetary policy is not clear as further rate hikes from the Bank of England will very much depend on the final Brexit outcome and, especially, on how resilient the economy will (still) be next year.

Disclaimer

Chief editor: Pascal Blanqué

Editor: Philippe Ithurbide

In the European Union, this document is only for the attention of “Professional” investors as defined in Directive 2004/39/EC dated 21 April 2004 on markets in financial instruments (“MIFID”), to investment services providers and any other professional of the financial industry, and as the case may be in each local regulations and, as far as the offering in Switzerland is concerned, a “Qualified Investor” within the meaning of the provisions of the Swiss Collective Investment Schemes Act of 23 June 2006 (CISA), the Swiss Collective Investment Schemes Ordinance of 22 November 2006 (CISO) and the FINMA’s Circular 08/8 on Public Advertising under the Collective Investment Schemes legislation of 20 November 2008. In no event may this material be distributed in the European Union to non “Professional” investors as defined in the MIFID or in each local regulation, or in Switzerland to investors who do not comply with the definition of “qualified investors” as defined in the applicable legislation and regulation. This document is not intended for citizens or residents of the United States of America or to any “U.S. Person”, as this term is defined in SEC Regulation S under the U.S. Securities Act of 1933. This document neither constitutes an offer to buy nor a solicitation to sell a product, and shall not be considered as an unlawful solicitation or an investment advice. Amundi accepts no liability whatsoever, whether direct or indirect, that may arise from the use of information contained in this material. Amundi can in no way be held responsible for any decision or investment made on the basis of information contained in this material. The information contained in this document is disclosed to you on a confidential basis and shall not be copied, reproduced, modified, translated or distributed without the prior written approval of Amundi, to any third person or entity in any country or jurisdiction which would subject Amundi or any of “the Funds”, to any registration requirements within these jurisdictions or where it might be considered as unlawful. Accordingly, this material is for distribution solely in jurisdictions where permitted and to persons who may receive it without breaching applicable legal or regulatory requirements. The information contained in this document is deemed accurate as at the date of publication set out on the first page of this document. Data, opinions and estimates may be changed without notice.

You have the right to receive information about the personal information we hold on you. You can obtain a copy of the information we hold on you by sending an email to info@amundi.com. If you are concerned that any of the information we hold on you is incorrect, please contact us at info@amundi.com.

Document issued by Amundi, “société par actions simplifiée”- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

Photo credit: iStock by Getty Images - metamorworks; blackdovfx

Amundi
ASSET MANAGEMENT
Research & Macro Strategy

Amundi Research Center

Top-down

Asset Allocation

Bottom-up

Corporate Bonds

Fixed Income

Foreign Exchange

Money Markets Equities

Find out more about Amundi research team

research-center.amundi.com

Monetary Policies

Forecasts

Investment Strategies

Quant

Emerging Markets

Sovereign Bonds

Private Equity

Real Estate High Yield

2019 Outlook Special Issue

Contributors

AINOUZ Valentine, Rates & FX Research Strategist
ARIAS Pedro Antonio, Global Head of Real & Alternative Assets
BERARDI Alessia, Deputy Head of Macroeconomic Research
BERTINO Claudia, Head of Amundi Investment Insights Unit
BERTONCINI Sergio, Head of Rates & FX Research
BLANQUÉ Pascal, Group Chief Investment Officer
BOROWSKI Didier, Head of Macroeconomic Research
BRARD Eric, Head of Fixed Income
CESARINI Federico, Multi-Asset Strategist
DEFEND Monica, Head of Strategy, Deputy Head of Research
DELBÒ Debora, Equity Strategist
DRABOWICZ Alexandre, Deputy Head of Equity
FIOROT Laura, Deputy Head of Amundi Investment Insights Unit
FORTES Roberta, FX Strategist
GERMANO Matteo, Head of Multi-Asset
ITHURBIDE Philippe, Global Head of Research
MIJOT Eric, Head of Equity Strategy, Deputy Head of Strategy Research
MORTIER Vincent, Deputy Group Chief Investment Officer
PIRONDINI Marco, Head of Equities, US
PORTELLI Lorenzo, Head of Cross Asset Research
SYZDYKOV Yerlan, Head of Emerging Markets
TAUBES Kenneth J., CIO of US Investment Management
TROTTIER Laurent, Global Head of ETF, Indexing, Smart Beta Management
WANE Ibra, Equity Strategist

Editor

ITHURBIDE Philippe, Global Head of Research

Deputy-Editors

BOROWSKI Didier, Head of Macroeconomic Research
DEFEND Monica, Head of Strategy, Deputy Head of Research

Conception & production

BERGER Pia, Research and Macro Strategy
PONCET Benoit, Research and Macro Strategy