Brexit sucking up oxygen from the FX market

March 13th, 2019

- **Brexit fear diminishing boosting GBP and other currencies**
- **Eurozone IP rebounds, the first sign of stabilisation**
- **Pressure increases for a rate cut in Australia**

Quick overview

We can see a case for GBP to rise towards 1.40 helping recoveries in EUR and AUD, and weakening the USD more broadly. But the outlook for a more sustained period of low EUR rates, no structural underweight in EUR, and limited demand for Euro assets suggest that its upside may be limited. Rate cut expectations have reached a new peak in Australia, and the AUD should continue to remain heavy. Chinese economic reports (trade, credit, PMIs) have been weak, Jan/Feb activity data are due later today. The overall outlook for the USD remains mixed and cautious trading continues to be advised. Event risk will keep traders playing the short game.

Brexit fear diminishing boosting GBP and other currencies

Brexit is sucking up a lot of oxygen in the FX market. The GBP is rising as fear of a no deal cliff edge diminishes. Following the decisive defeat of her plan, PM May has paved the way for the parliament to vote to reject a no deal Brexit, and then seek an extension. This appears to raise the chances of a softer Brexit; remaining in a customs union.

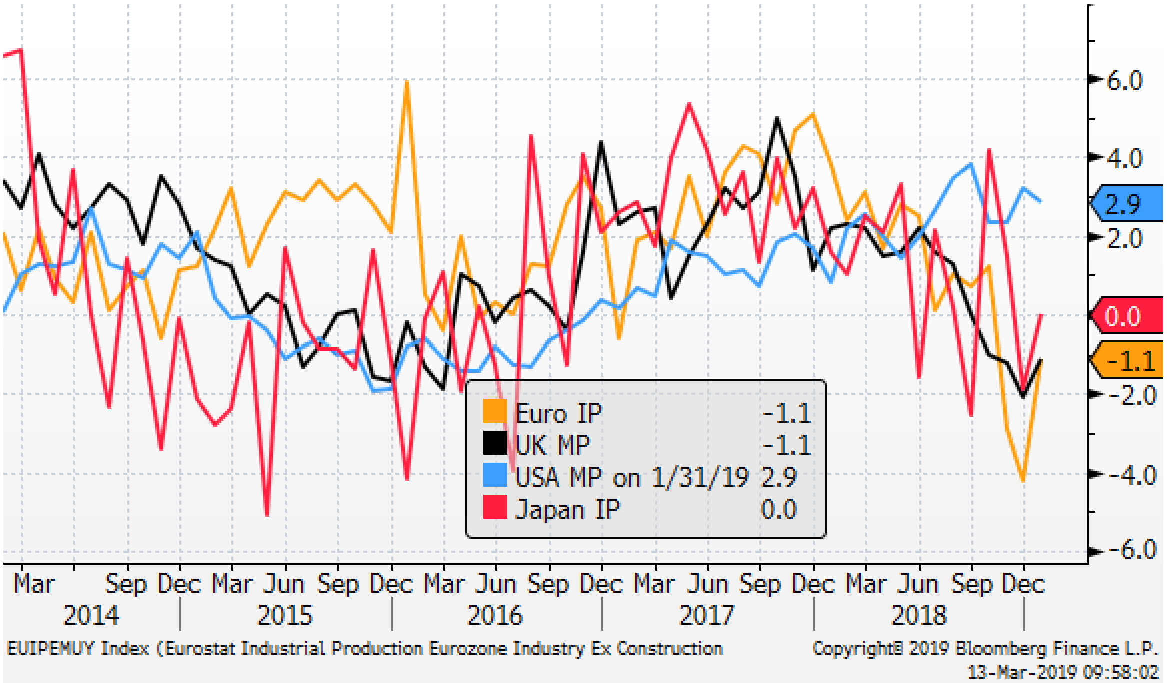
GBP is responding by rising strongly and helping lift the EUR and other currencies against the USD. This has the potential to continue to dominate in the near term. If softer Brexit options gain momentum, GBP could rise towards 1.40 and continue to drag up EUR and by extension other currencies.

We see upside to around GBP/USD 1.40 if soft Brexit options gain ascendancy

Eurozone IP rebounds

Eurozone industrial production was stronger than expected in Jan, a first sign that the weaker trend in economic data through recent months may be abating. However, PMIs in the Eurozone were still depressed early this year, so confidence in recovery should still be tempered.

G4 – Industrial production %y/y Eurozone rebounds from -4.2% in Dec to -1.1%y/y in Jan

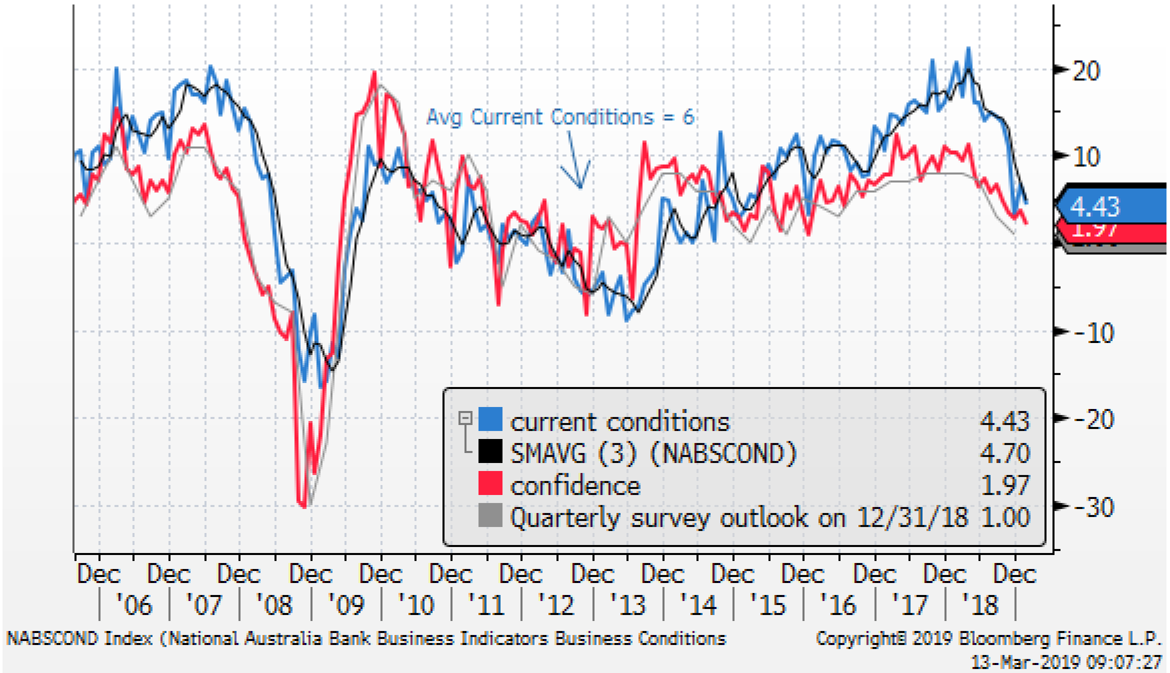


Pressure increases for a rate cut in Australia

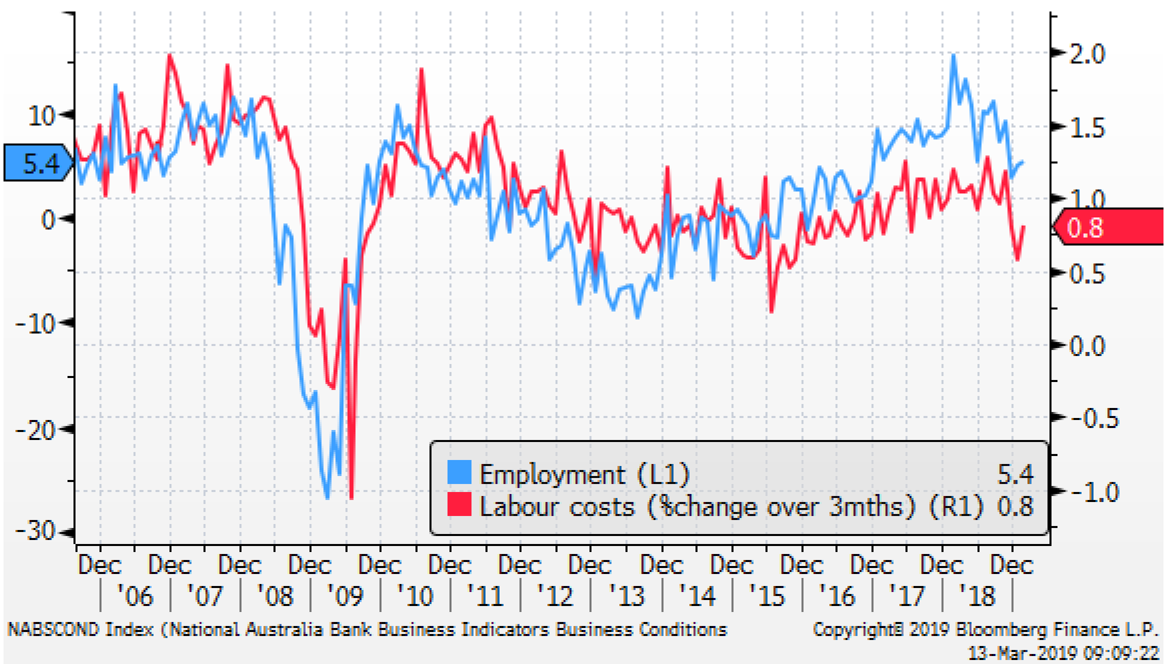
Australian economic reports point to increased risks of subdued below-trend economic growth forcing the RBA to cut rates before too long.

The business and consumer confidence reports for February deteriorated.

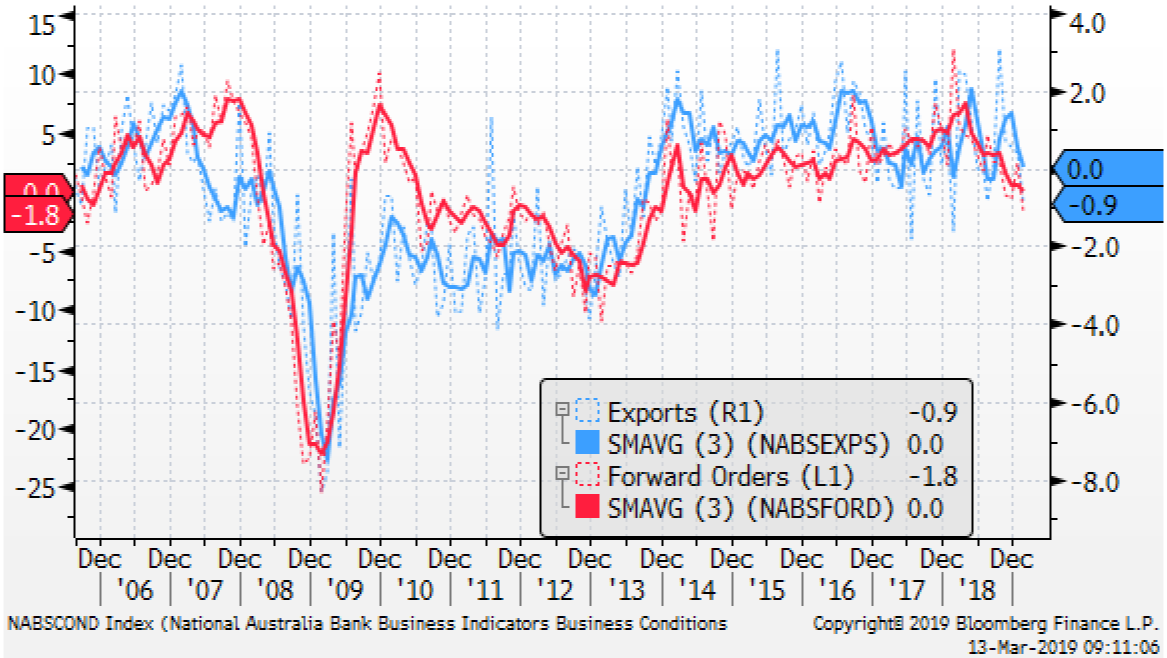
NAB business survey - Confidence (4) and Conditions (2) below the long-run average



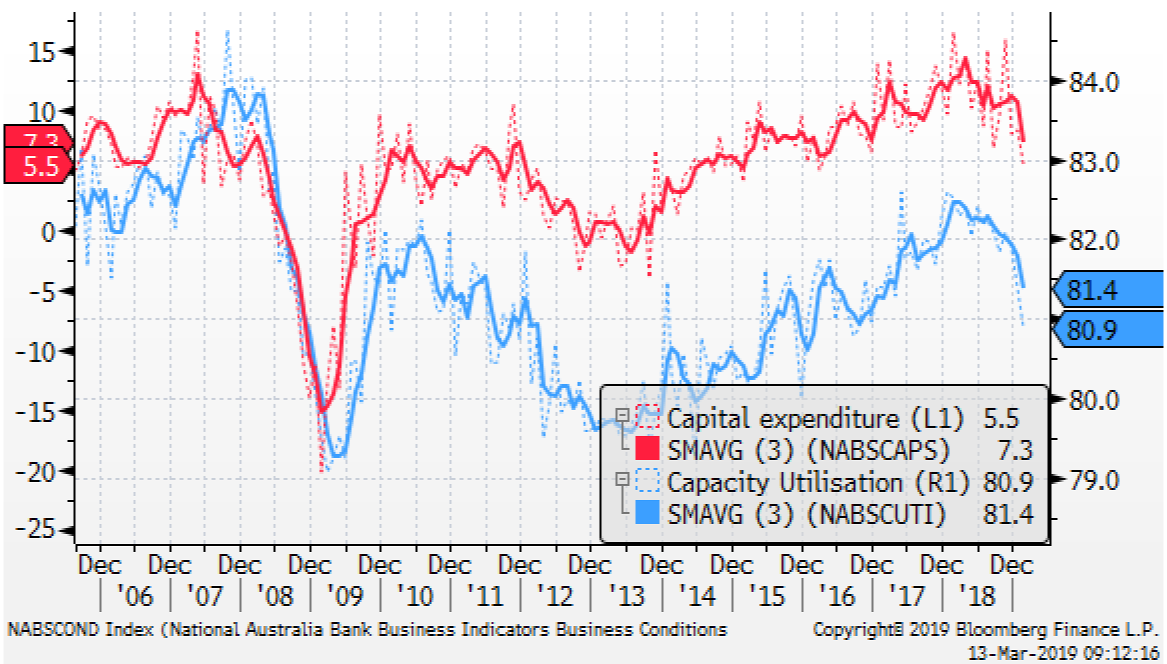
NAB business survey - Employment Conditions have edged up in Jan/Feb, but are around the lows since 2016 after falling in Q4



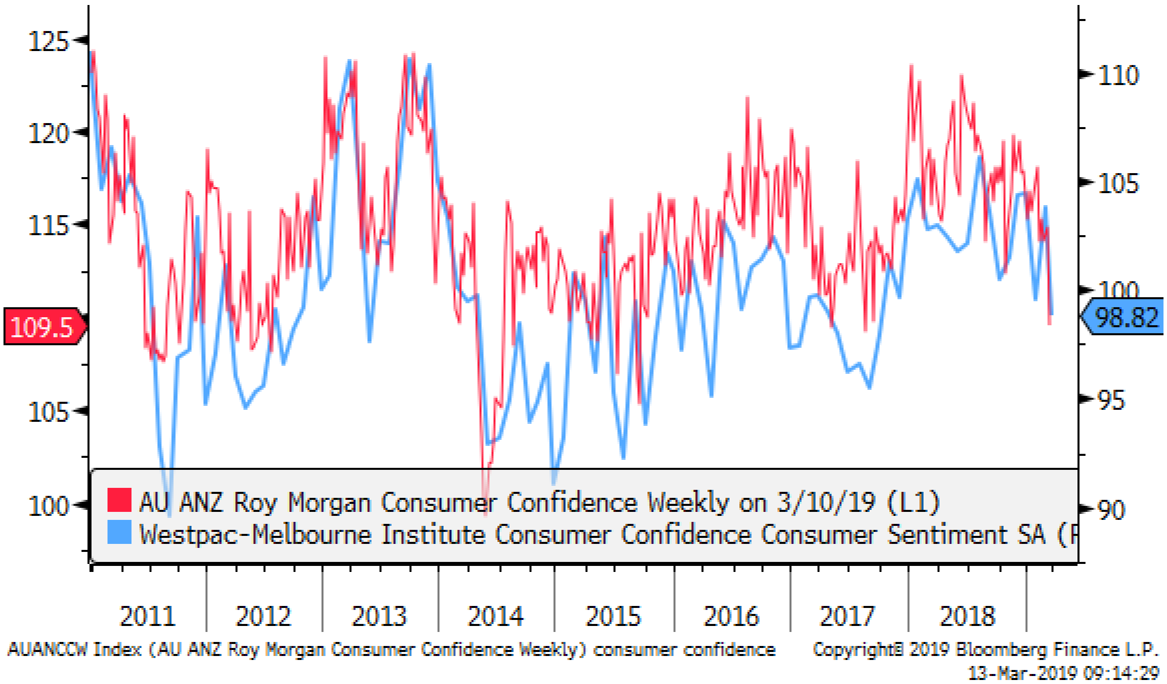
NAB business survey - Order book at the weakest since 2014



NAB business survey - Capital Expenditure plans and Capacity Utilization at lows since 2016



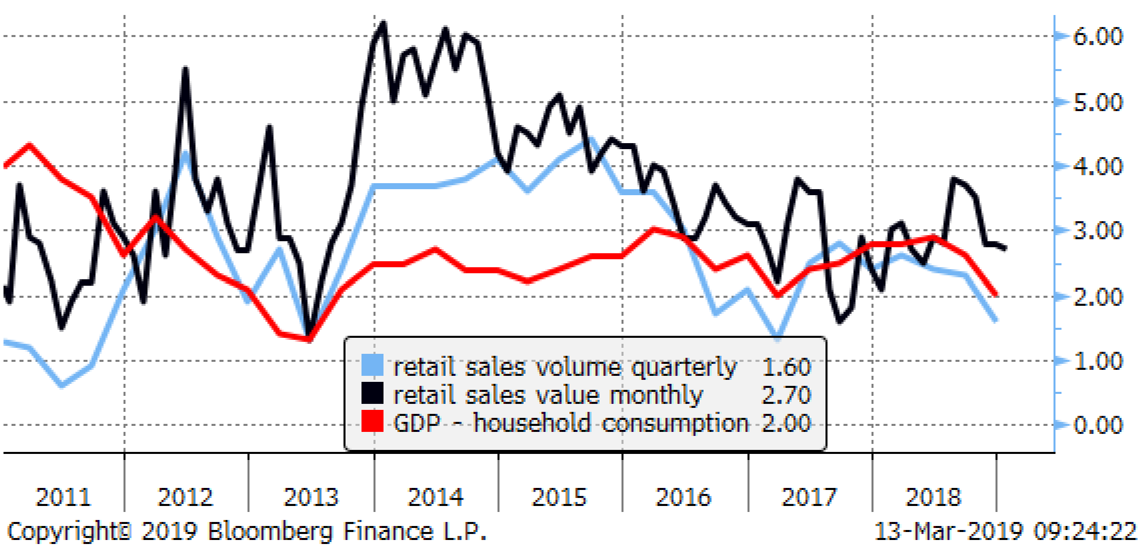
Weekly and Feb Month consumer confidence readings fell abruptly to the low end of the range over the last few years, now modestly below their long-run averages



The monthly housing finance approvals in Jan retained their down-trend suggesting that the housing market is no closer to ending its decline over the last 18 months.

Following the weaker than expected Q4 GDP data released last week, a day after the RBA policy meeting, retail sales for January were weaker than expected (+2.7%y/y); with weakness pronounced in discretionary items; including household goods (-0.7%y/y), pointing to the dampening impact of the weak housing market.

Australian household spending weaker %y/y



The RBA may be waiting for clearer evidence that the weaker sentiment, housing, and household spending data are spilling over to a weaker labour market that to date has remained strong. February labour data is due next week.

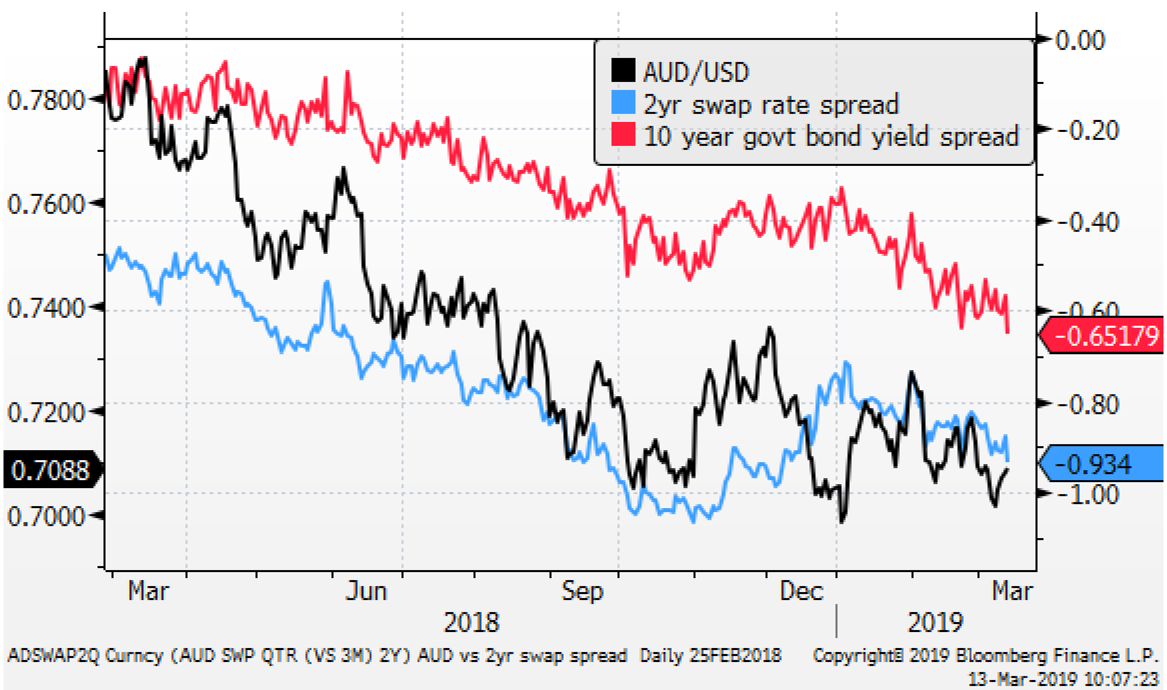
The RBA may hope that robust government infrastructure spending, the end of the mining investment downturn, robust commodity prices, Chinese policy stimulus, and a rebound in the global economy from its second half 2018 slump combine to lift Australian business confidence out of its recent slump and restores its relatively upbeat outlook for Australian business investment.

However, the early weakness in global PMI reading into Feb and broader market sentiment suggests that any rebound in global growth this year will be gradual. In the meantime, risks to the Australian economy from the housing market downturn, spreading to consumption and a faster downturn in residential construction, have increased. If the labour market loses momentum next week, the RBA will be pressured to consider 'insurance policy' cuts.

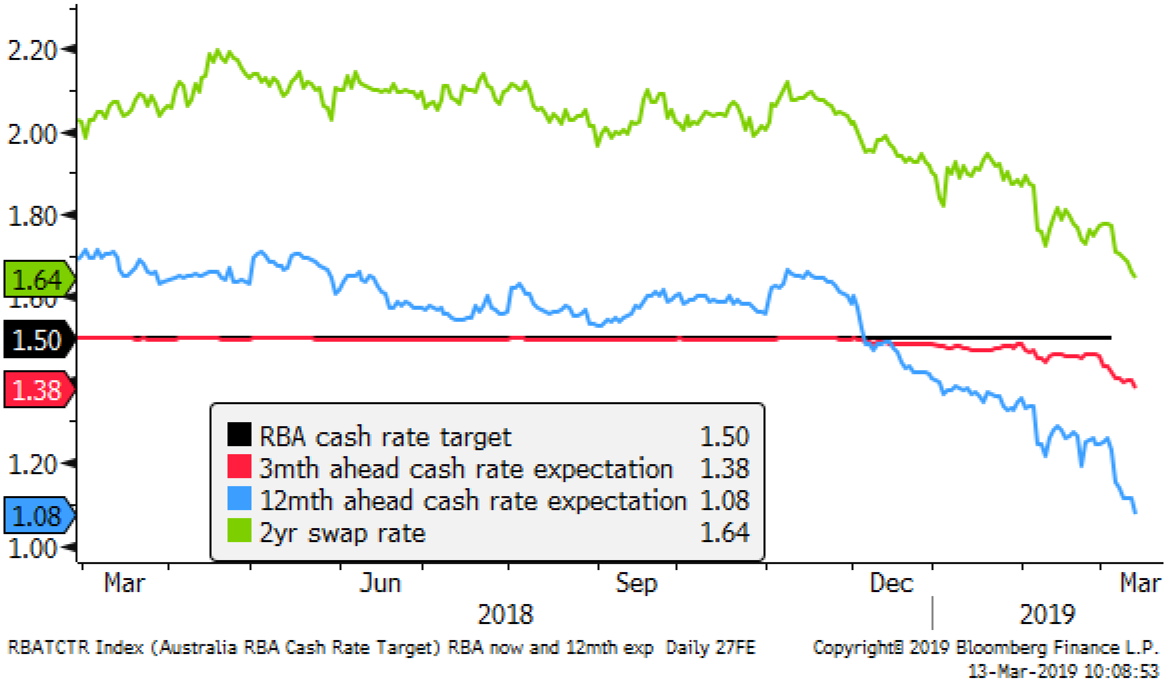
Chinese economic reports have been weaker than expected this year – trade and credit growth in February. Attention will turn to the activity indicators released later today for Jan/Feb.

The AUD has lifted this week against a weaker USD but is underperforming most other currencies. Some firming in commodity prices and firmer Chinese and global equities have provided support. The prospect of a US-China trade deal and stable Fed rates policy is helping support the AUD. The rebound in GBP and EUR is also helping underpin AUD.

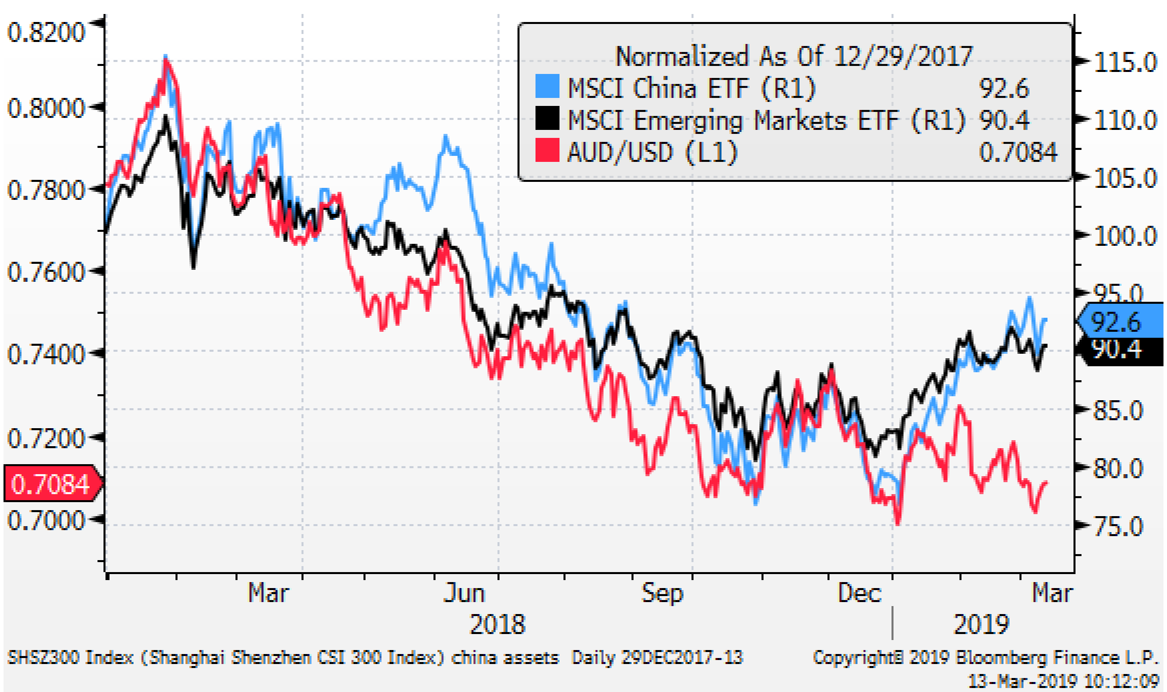
Increasing AUD/USD yield disadvantage



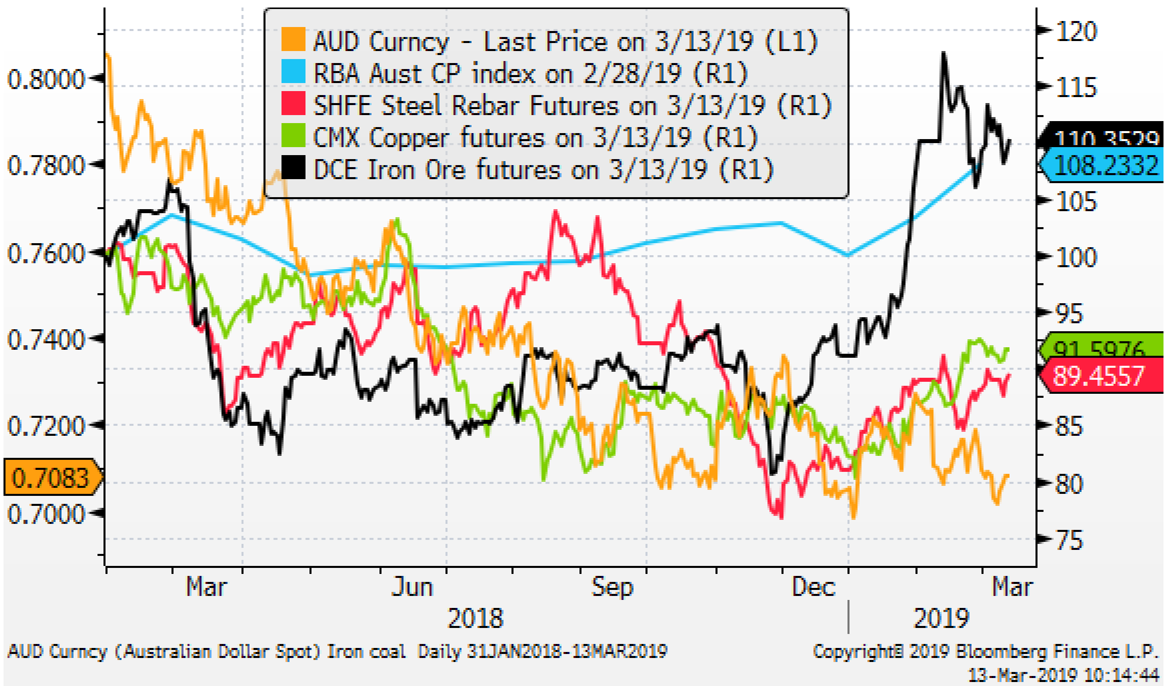
The market has 12bp of cuts priced in over three months, and 42bp over 12 months



Strong EM equities help support the AUD



Metals prices supporting the AUD



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