Dollar tests highs as global risk aversion remains elevated

Posted on April 23, 2019

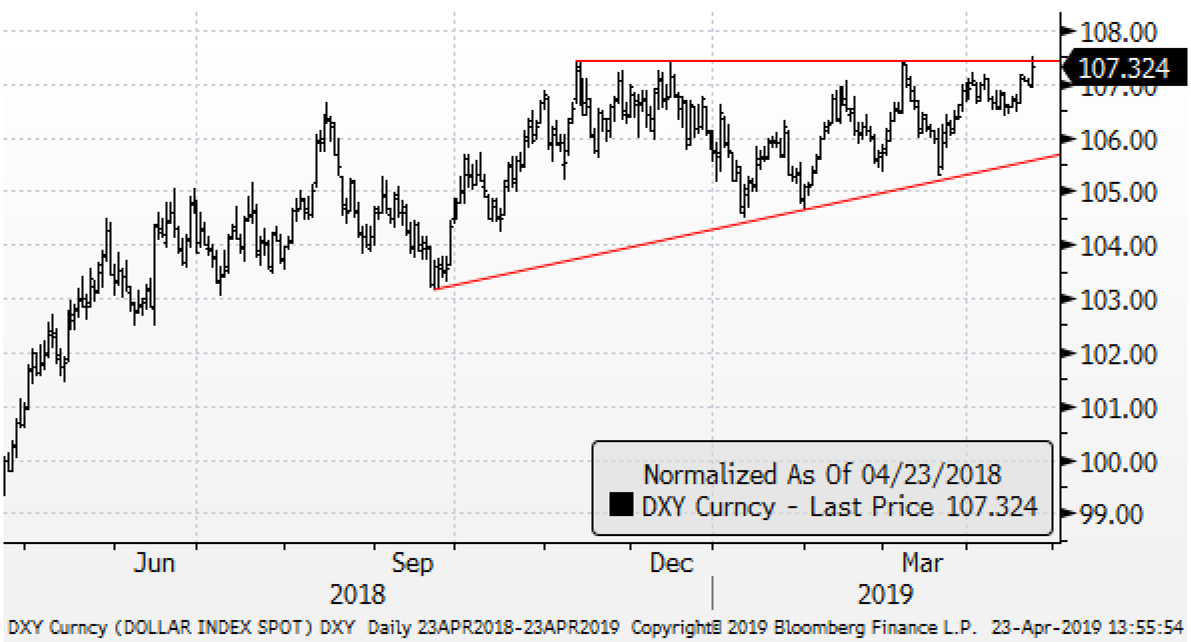
The USD is testing the top of its range for over a year against the DXY major currency index, and its highs for the year-to-date against the broader Bloomberg dollar index against ten leading currencies. The rebound in the USD is surprising in light of the stronger than expected Chinese economic data. However, other economic reports suggest that global manufacturing and export growth remains weak; including flash April PMIs and export data in Korea and Singapore. Strength in the dollar reflects some risk aversion related to higher oil prices on USA's Iran policy, Brexit risks, Italian government risks, and USA trade policy risks. US bond yields stalled, consistent with some risk aversion. However, US equities powered to new closing highs.

Dollar tests highs

On the first full trading day after Easter, the USD is broadly stronger, extending gains late last week. The USD is testing towards the strong side of its recent range, but only after testing the weak side last week, so it may just be continuing in a ranging pattern over recent months.

There is no clear new fundamental reason to anticipate a break-out towards a stronger USD. But the rebound in the USD, so far this week, is a bit more rapid than its earlier fall, so it may be spooking the market a bit, suggesting it may break some technical levels and run further.

DXY dollar index against major currencies –testing highs over the last year



Bloomberg dollar index against ten leading global currencies – testing highs for the year-to-date

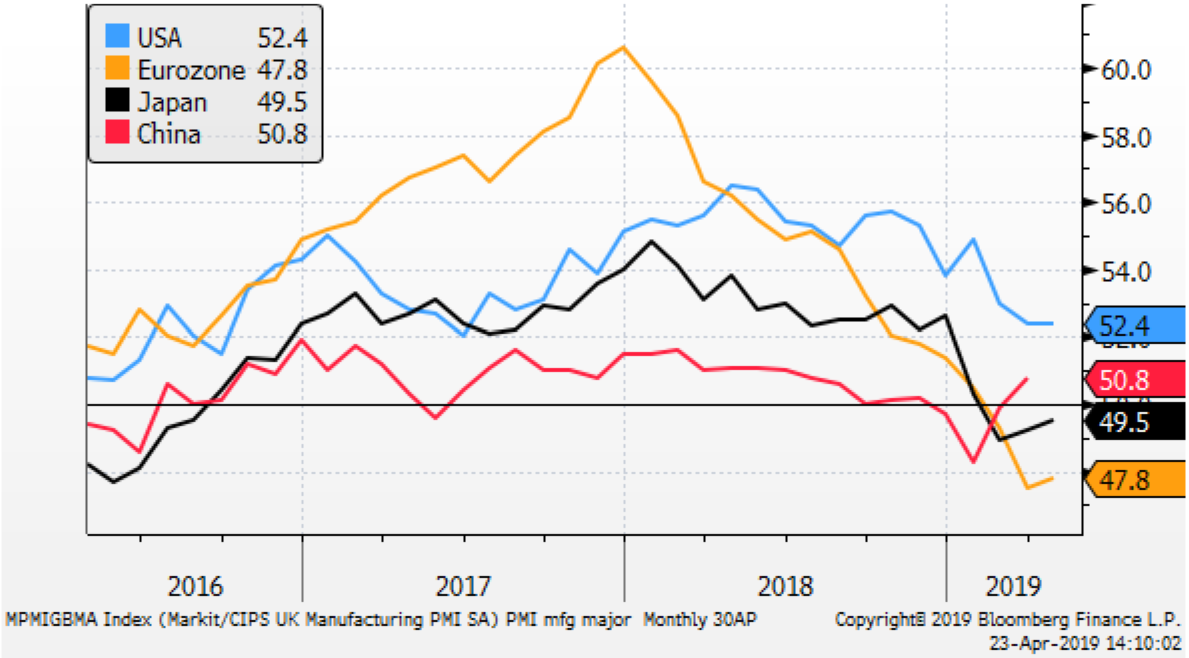
Global growth indicators remain soft

The decline in the USD a week ago was fueled by stronger than expected Chinese economic data, raising hopes that the global economy may be lifting out of its funk since around the middle of last year.

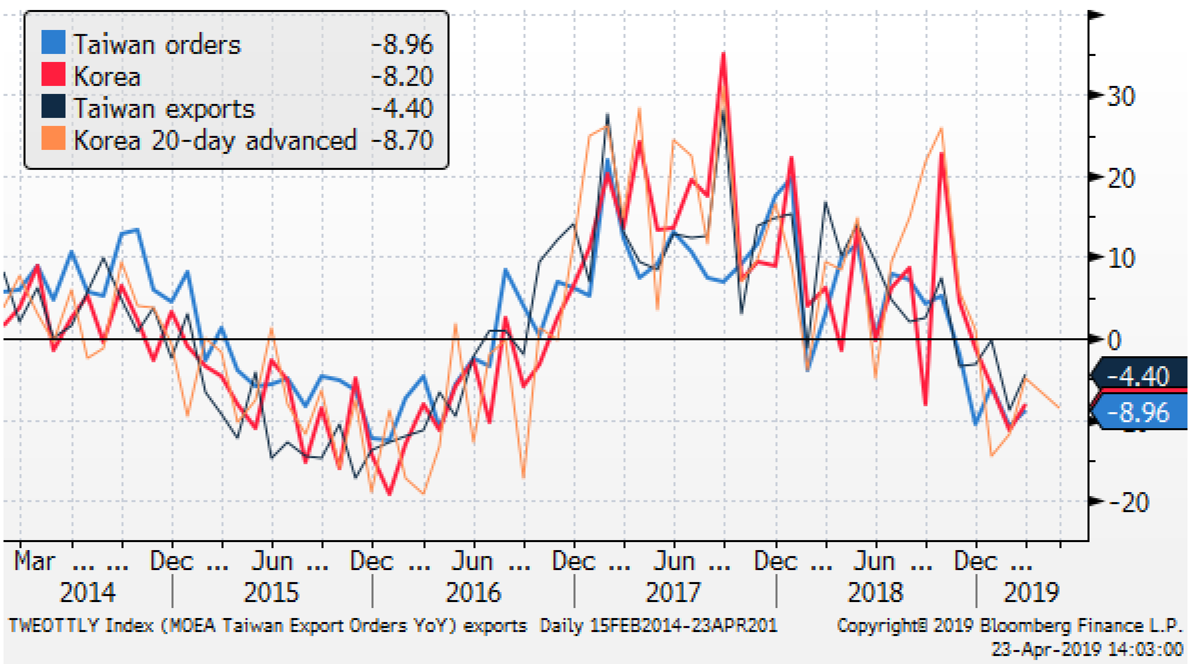
It is interesting that the FX and rates markets were not able to generate more optimism on signs of recovery in China. This suggests that the market remains sceptical that China can sustain a recovery and help support broader economic recovery.

The scepticism that China is or can lead a global recovery may reflect a lack of recovery in export growth in its Asian neighbours and ongoing weakness in flash manufacturing PMIs for the Eurozone, Japan and the USA.

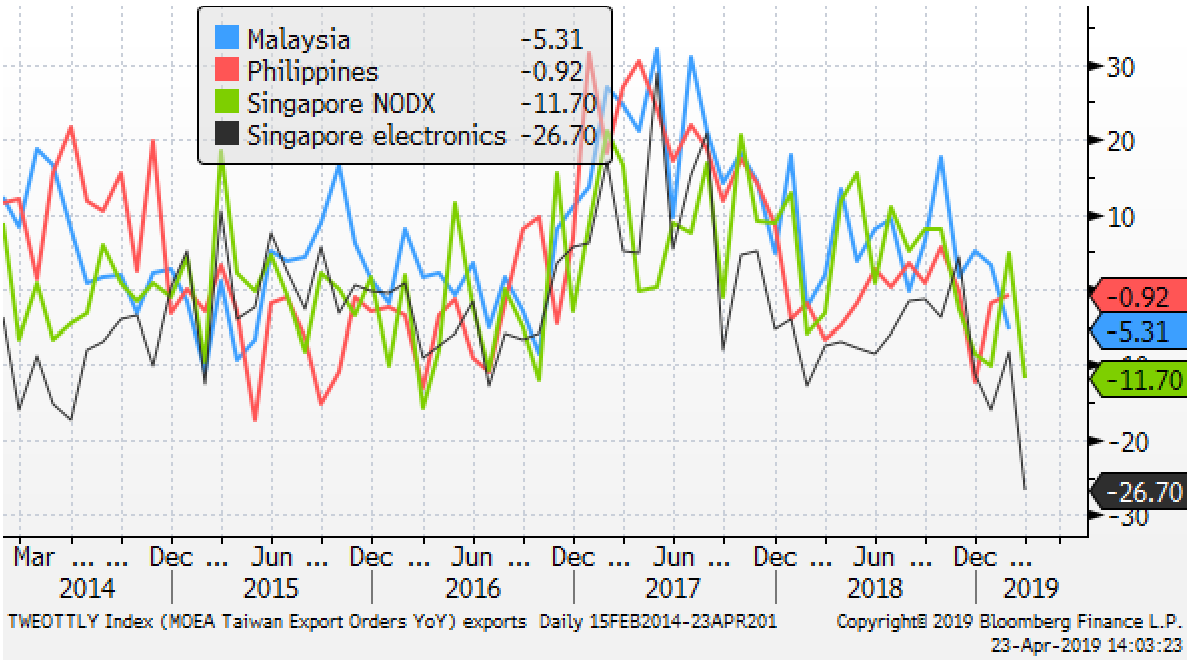
Flash manufacturing PMIs for April remain soft despite the bounce in March Chinese economic data



Export growth in Korea dipped in the first 20-days of April



Singapore electronics exports fell sharply in March



Risk aversion in FX remains elevated

There is an element of risk aversion in the FX moves so far this week. The USD has strengthened against most currencies, but JPY has strengthened somewhat against the USD, and US bond yields have retreated from their initial rise on Monday.

It's a relatively mild bout of risk aversion at this stage. It hasn't had much dampening impact on US equities, with the US S&P500 pushing up to around its peak last seen in September last year.

Some Asian equity markets were somewhat softer, which may reflect concern over the jump in oil prices on the US administration announcement that is was removing exemptions to its sanctions for importing oil from Iran.

It's possible that risk appetite may be dampened to some extent by the additional geopolitical risk of conflict in the Middle East, and specifically between the USA and Iran, generated by the USA's use of economic pressure on Iran to bow to its demands. The market may not be overly focused on geopolitical risk, but it is worth noting that broader US policy related to the Middle East is steadily ratcheting up risk of conflict; from its support of hard-line policy in Israel to naming Iran's Revolutionary Guard as a terrorist group.

Risk aversion may also reflect an uptick in tension in the UK parliament over Brexit.

Italian bond yields have led some widening in sovereign spreads over German bunds in the last two weeks as the market pays attention to the budget pressures in Italy arising from weak growth, tensions between the ruling parties, an additional supply of Italian bonds coming to market, and an S&P rating decision on Italy at end week. These factors may have more specifically weighed on GBP and EUR, although there was minimal new information on these ongoing issues.

On the other hand, there has been a significant narrowing in Greek and Portuguese spreads over the last month or so. Italy may be regarded as more important, but the market is not clearly pricing in contagion from Italy to other markets in the region.

Trade issues remain an issue of concern for global investors. While the market may now largely anticipate a trade deal between the US and China, its delay may be dampening investor confidence. Furthermore, the US president is tweeting more about his issues on trade with the EU, and both sides have threatened retaliatory tariffs on a range of goods.

Donald J. Trump @realDonaldTrump 10 hours ago

"Harley Davidson has struggled with Tariffs with the EU, currently paying 31%. They've had to move production overseas to try and offset some of that Tariff that they've been hit with which will rise to 66% in June of 2021." @MariaBartiromo So unfair to U.S. We will Reciprocate!

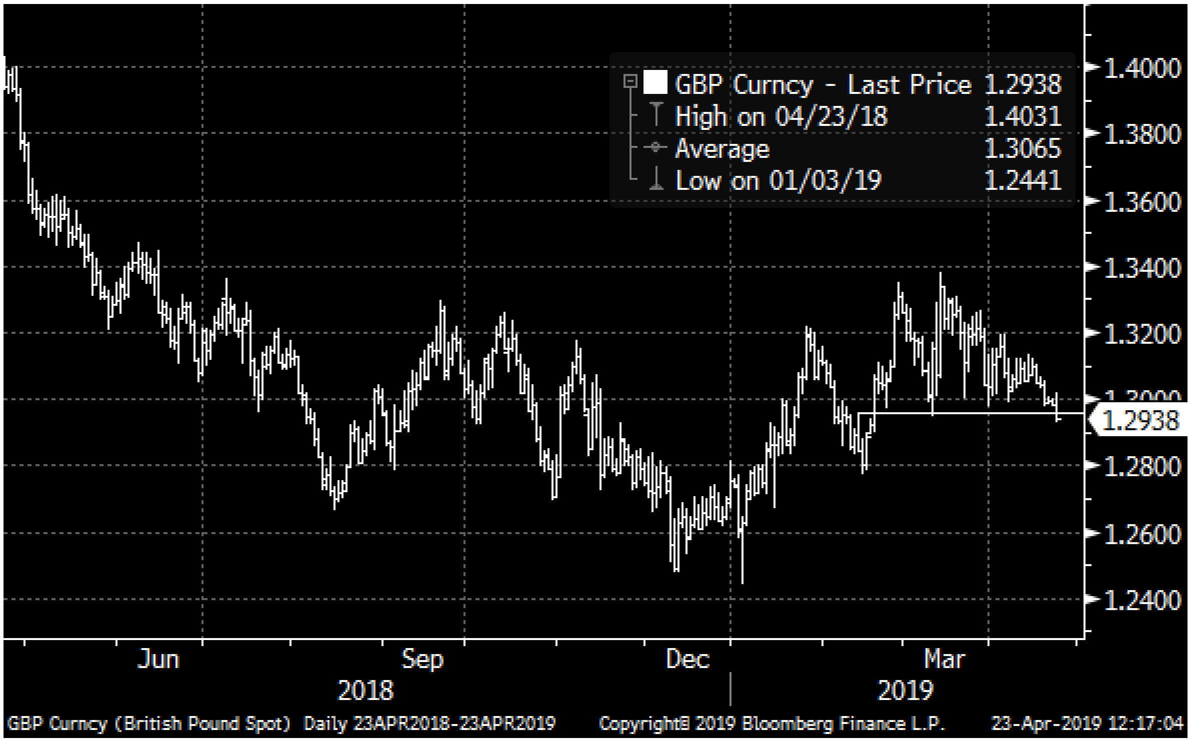
Donald J. Trump @realDonaldTrump Apr 10

Too bad that the European Union is being so tough on the United Kingdom and Brexit. The E.U. is likewise a brutal trading partner with the United States, which will change. Sometimes in life you have to let people breathe before it all comes back to bite you!

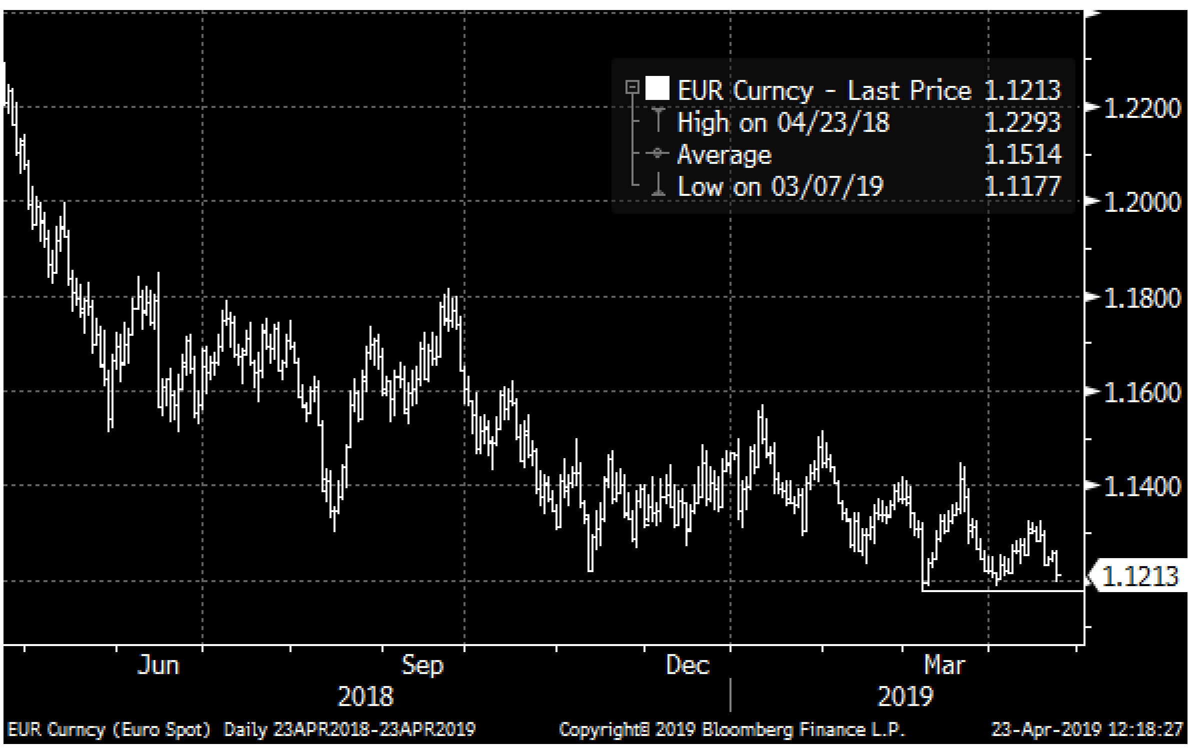
Donald J. Trump @realDonaldTrump Apr 9

The World Trade Organization finds that the European Union subsidies to Airbus has adversely impacted the United States, which will now put Tariffs on $11 Billion of EU products! The EU has taken advantage of the U.S. on trade for many years. It will soon stop!

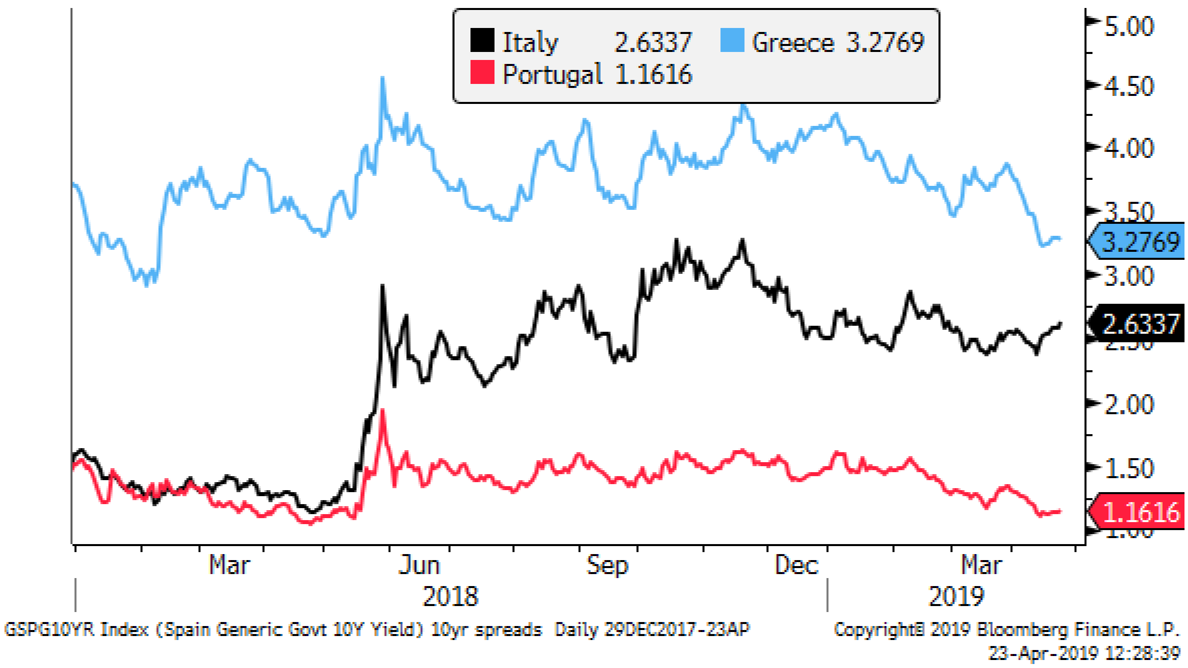
GBP moves below recent lows since Feb around 1.300



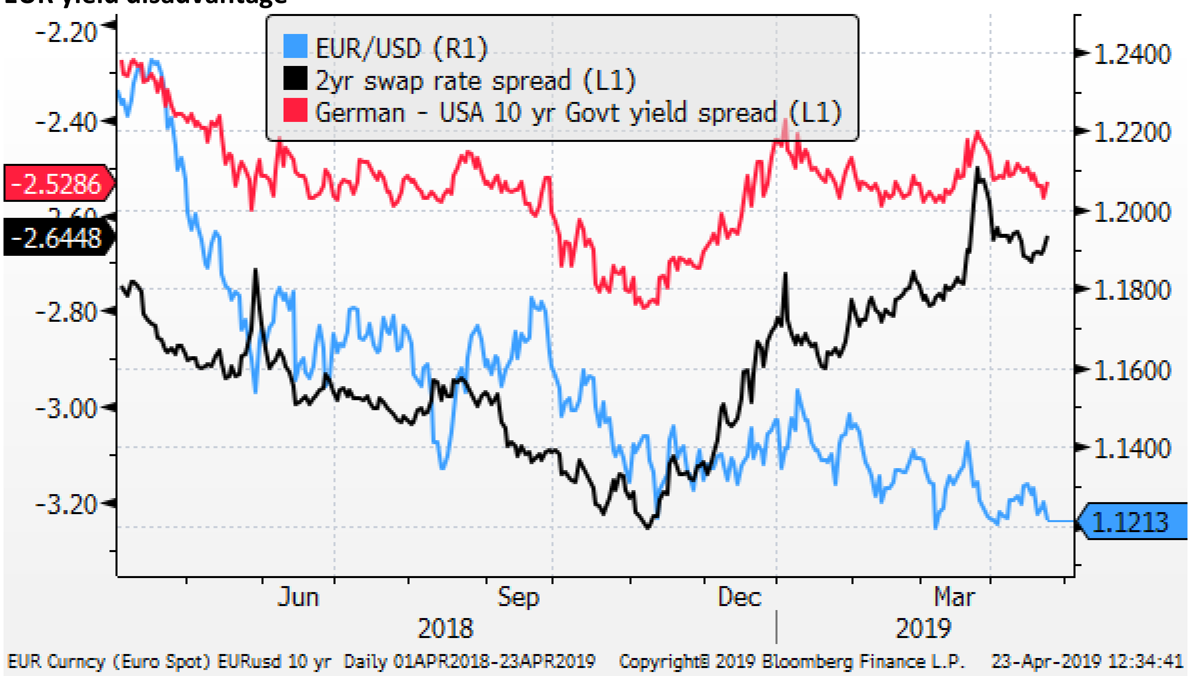
EUR testing recent lows around 1.1200



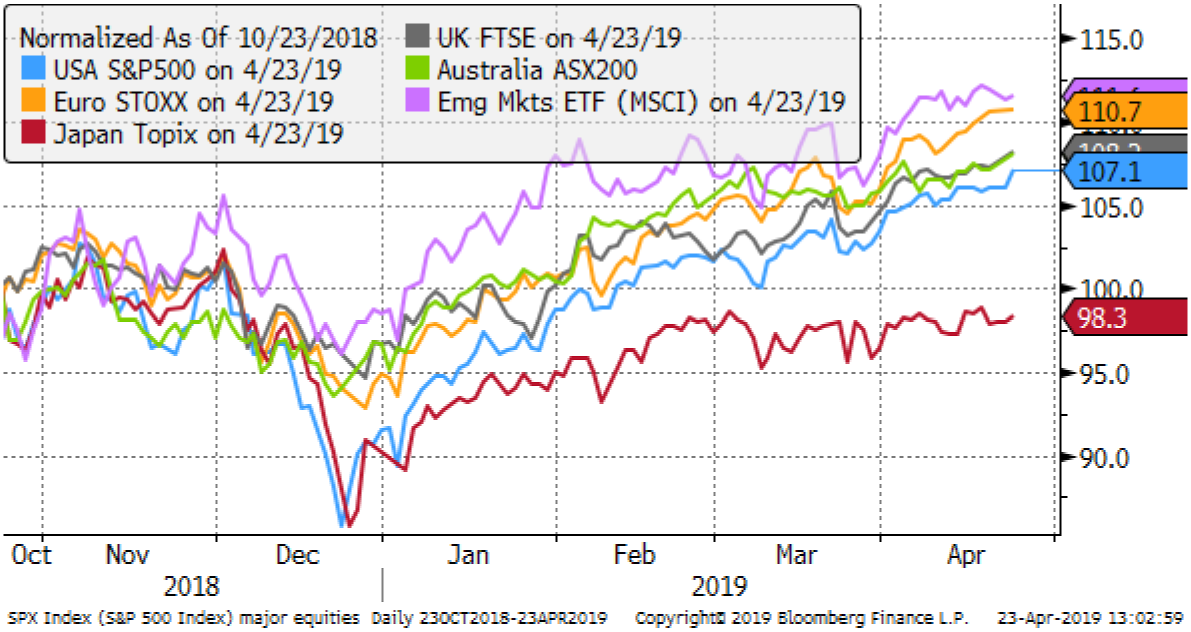
Eurozone 10 year periphery government spreads over German bunds- Italian spread creeps wider since a recent low on 11-April. However, there has been a significant improvement in Greek and Portuguese spreads in the last month or so



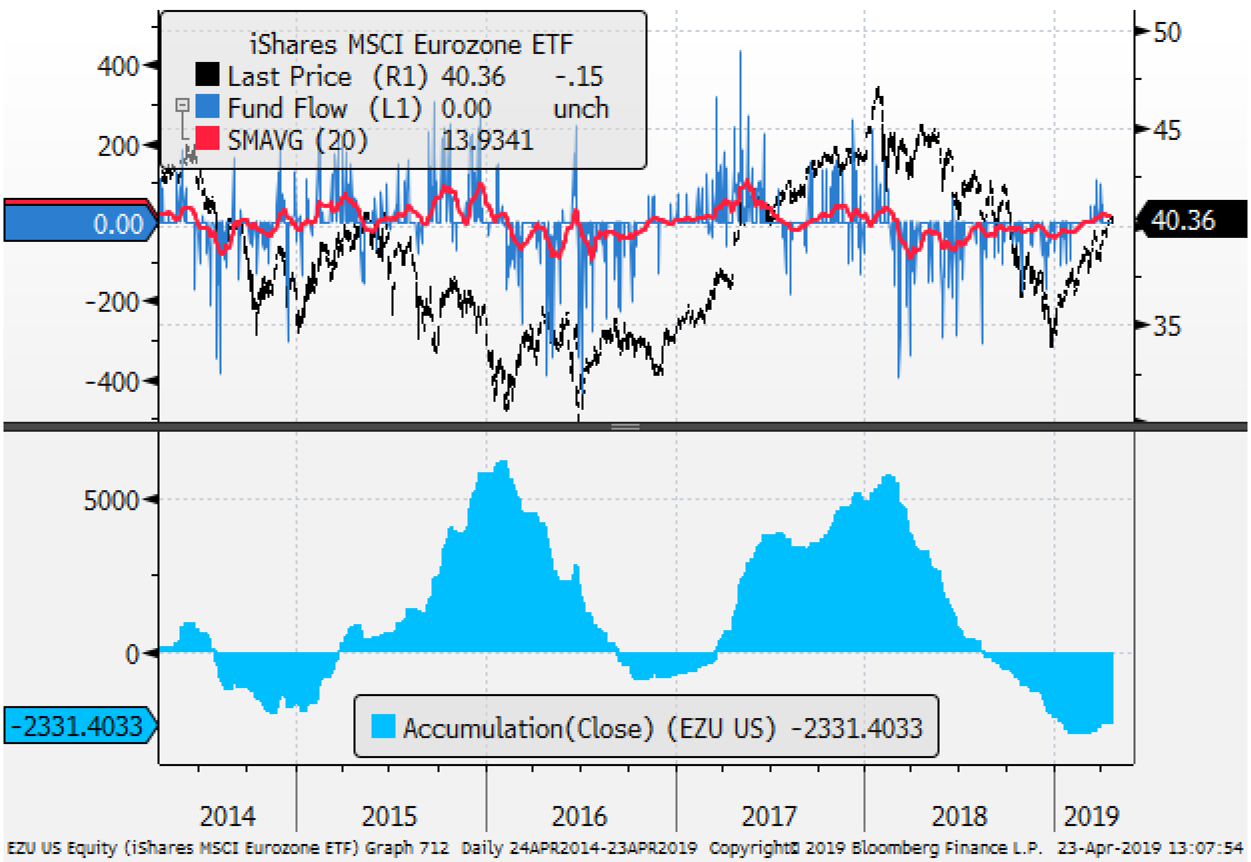
Short and long term yield spreads vs EUR/USD - Further weakness in the EUR this year despite a narrower EUR yield disadvantage



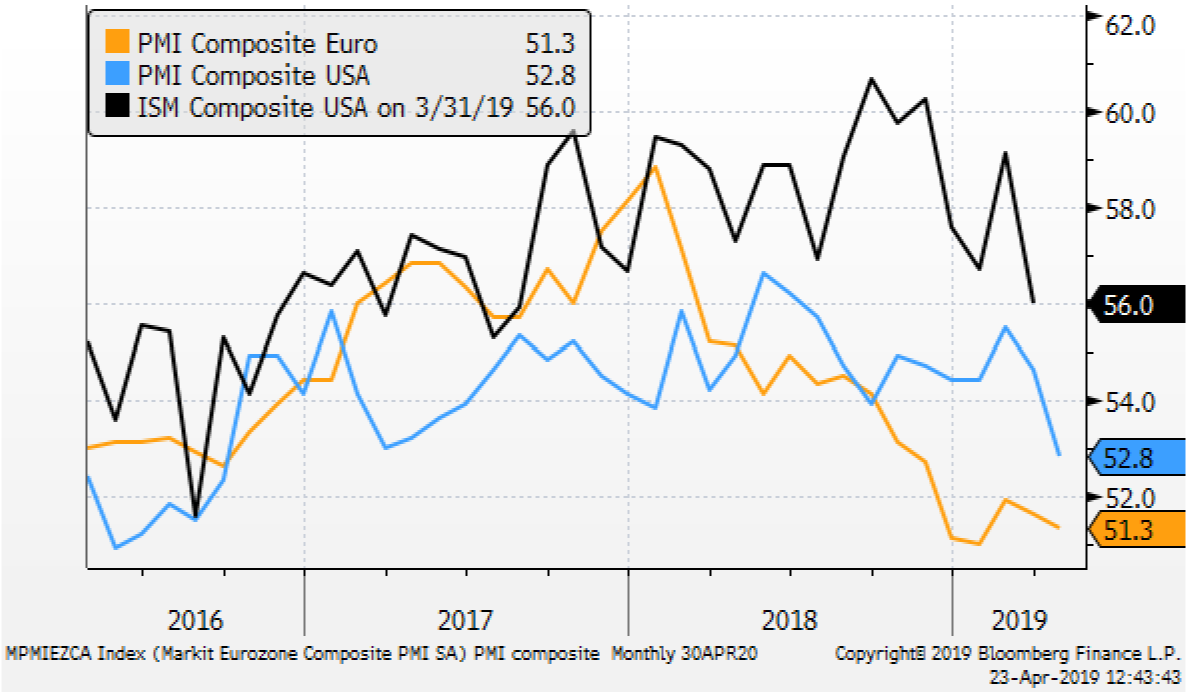
Major equity markets – Eurozone equities are on pace with the recovery in US equities this year

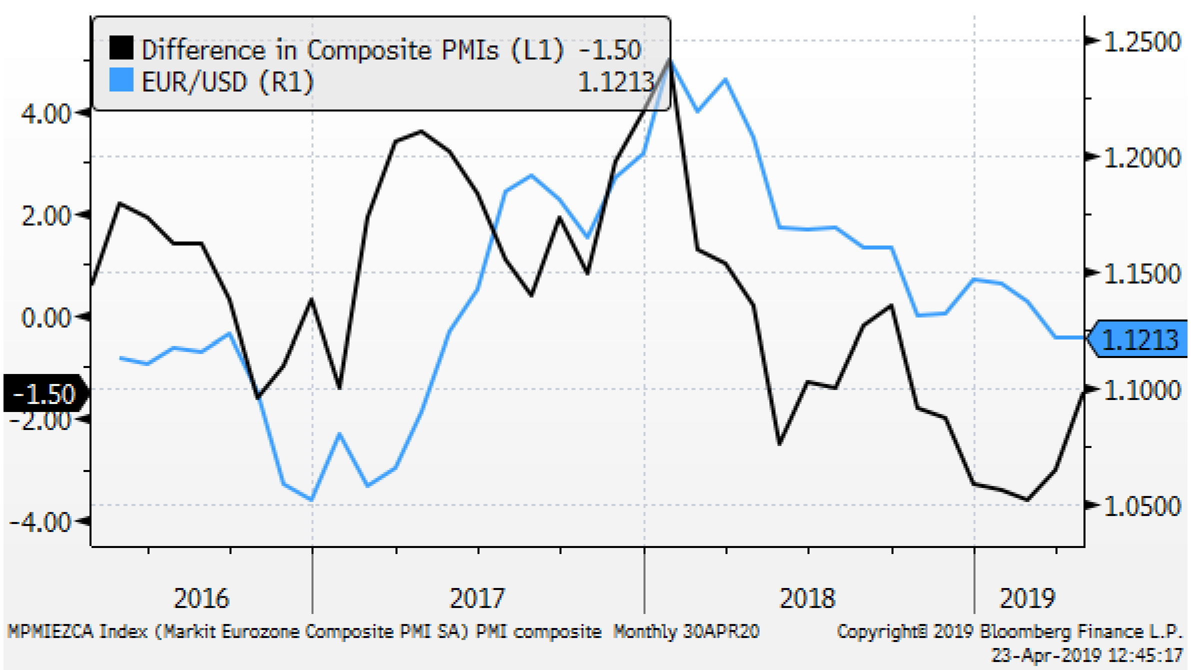


US-listed Eurozone equity ETF –flows into the Euro equity fund have turned modestly positive since mid-March after a period of outflows over the preceding year that more than reversed all the inflows in 2017

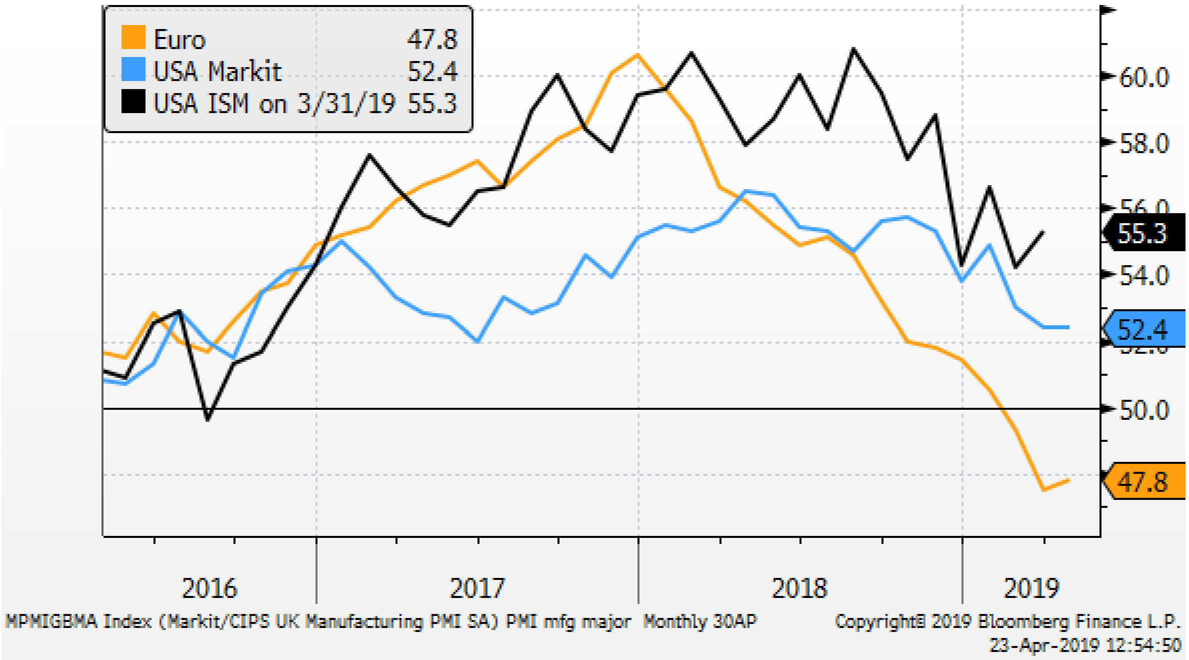


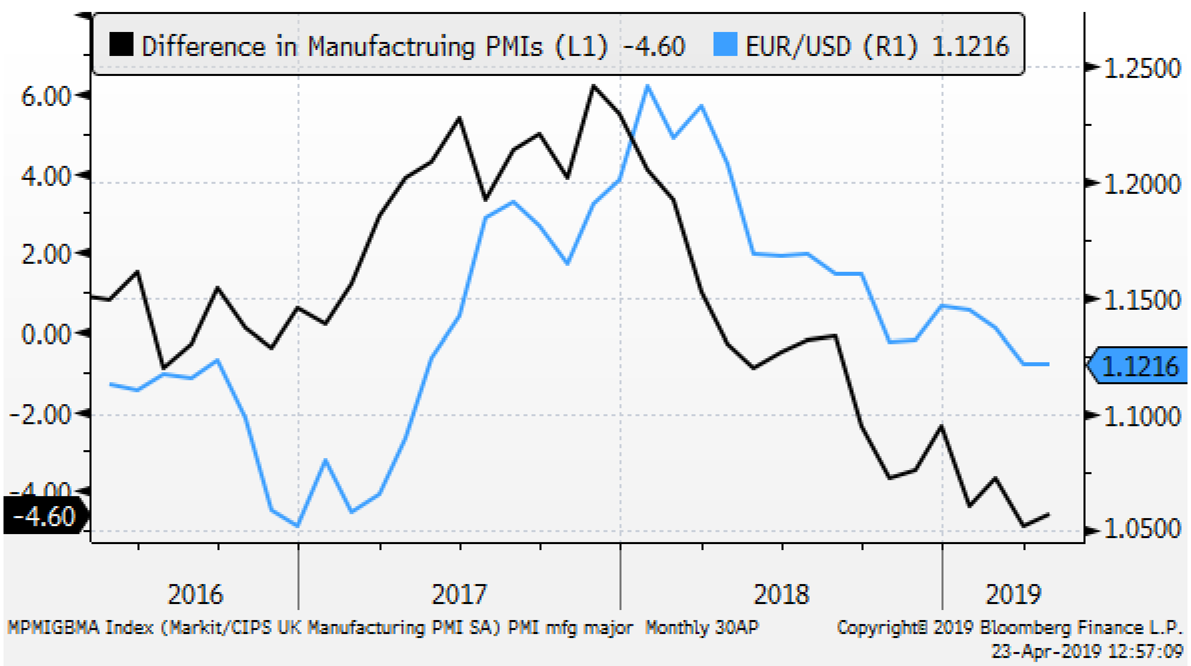
Composite PMIs from Markit – Eurozone remains relatively low in April, the USA fell in April to its lowest since 2016, narrowing the gap with the Eurozone



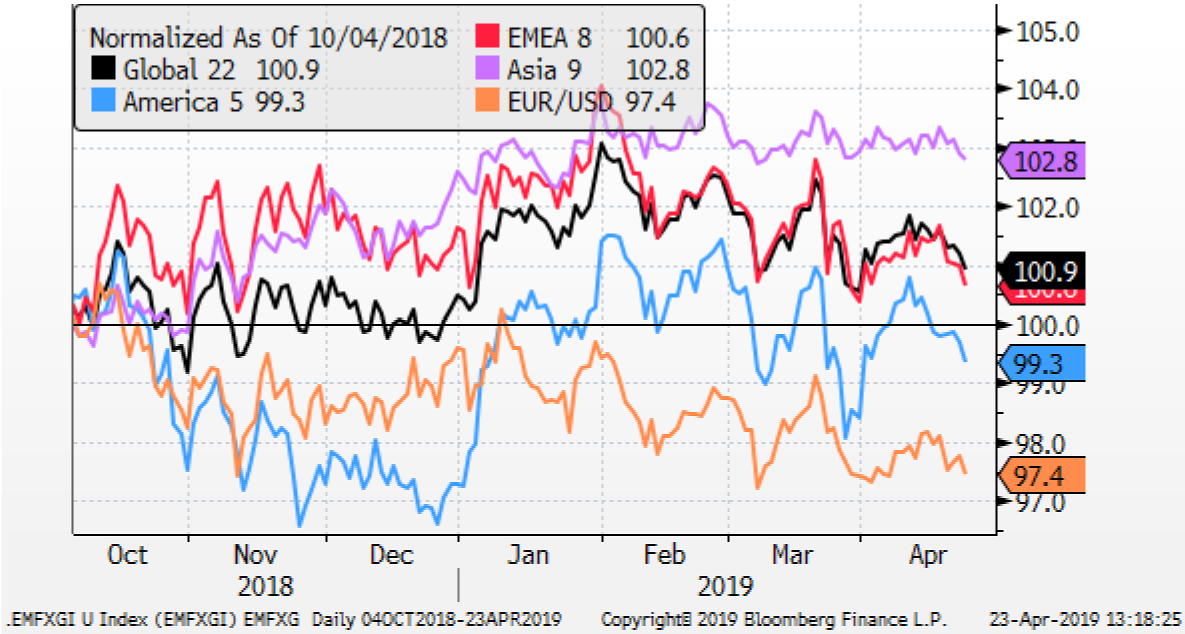


Manufacturing PMIs – Eurozone remained depressed in contraction in April. US steady at its lowest level since mid-2017. Performance gap still around its widened against the Eurozone in at least three years

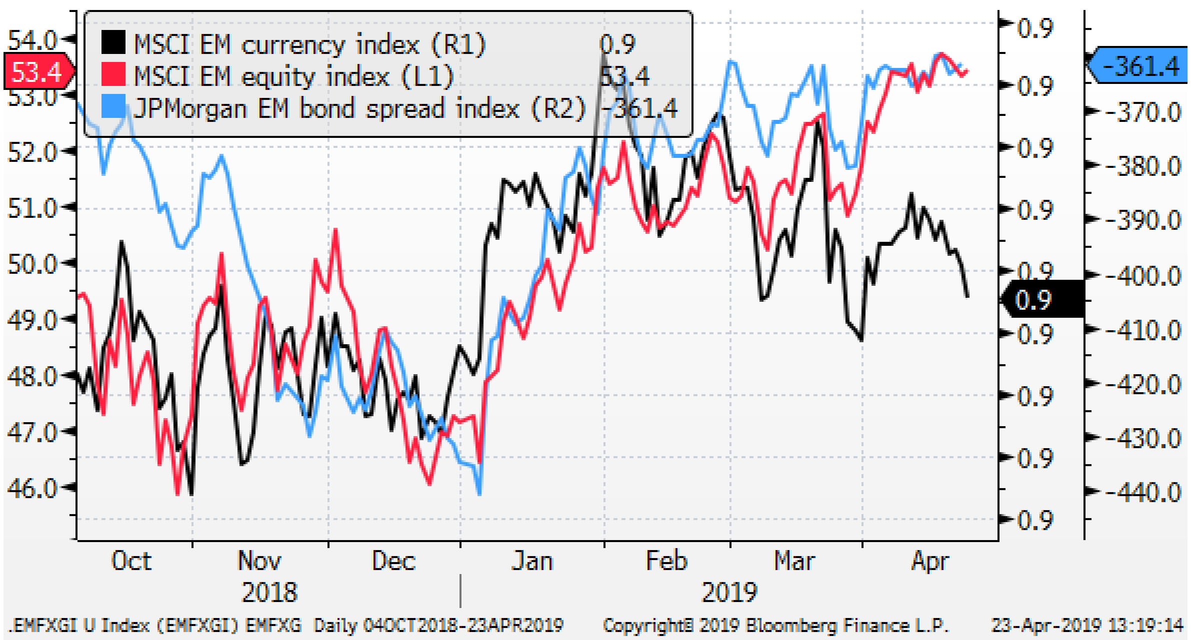




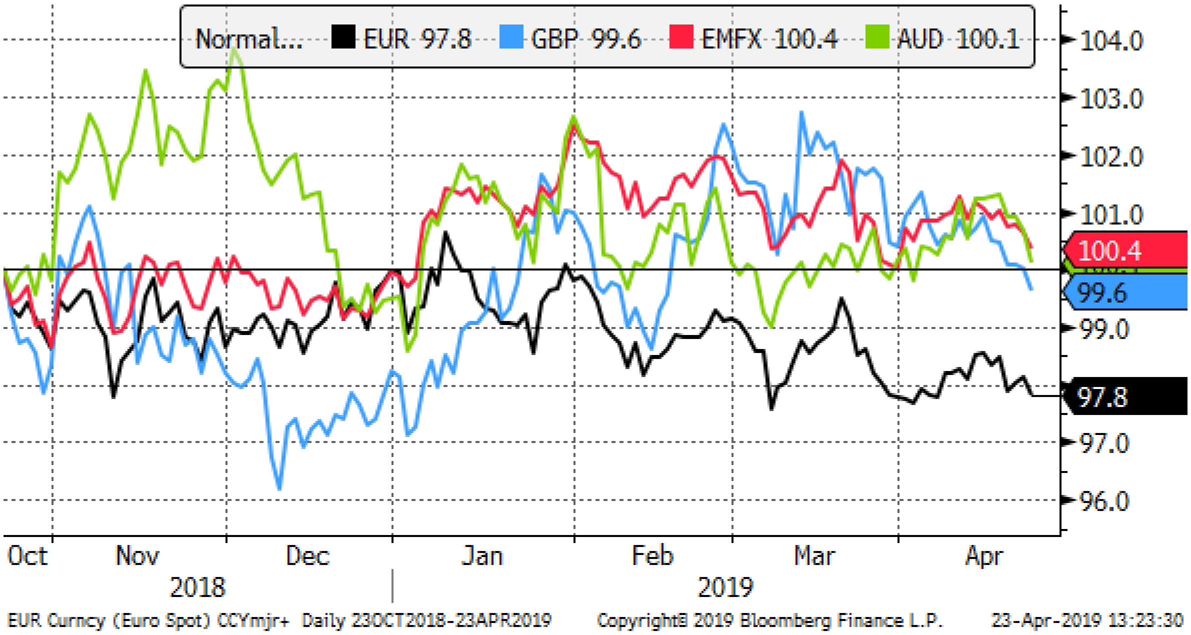
Emerging market currencies by region

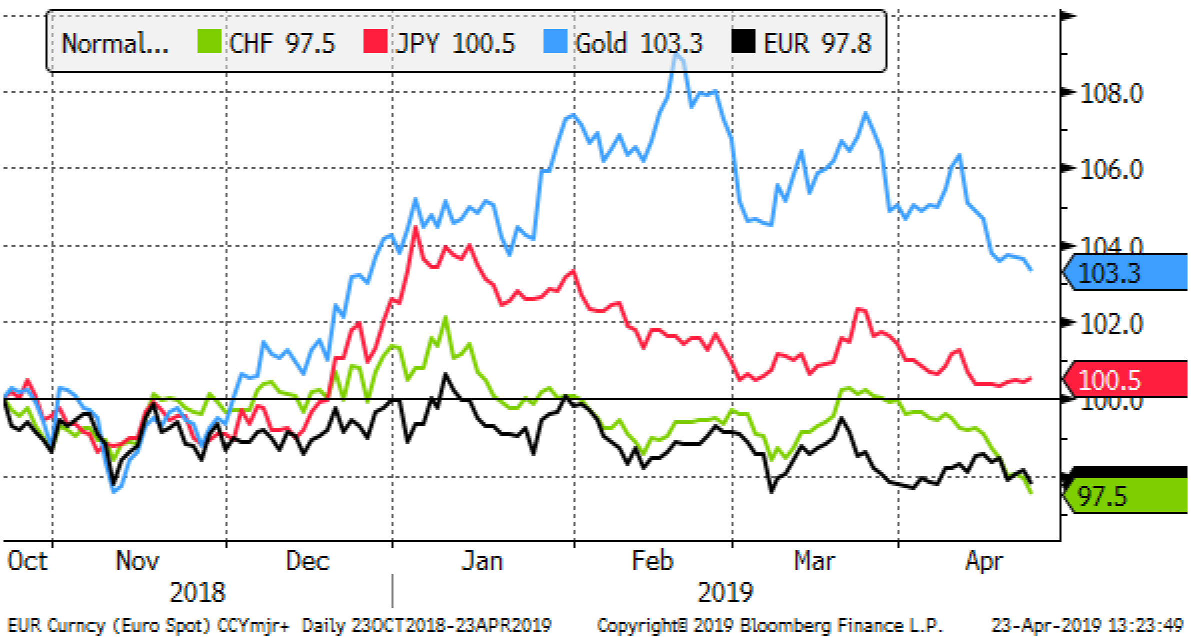


Weaker EM currencies in recent months despite stable to stronger EM assets

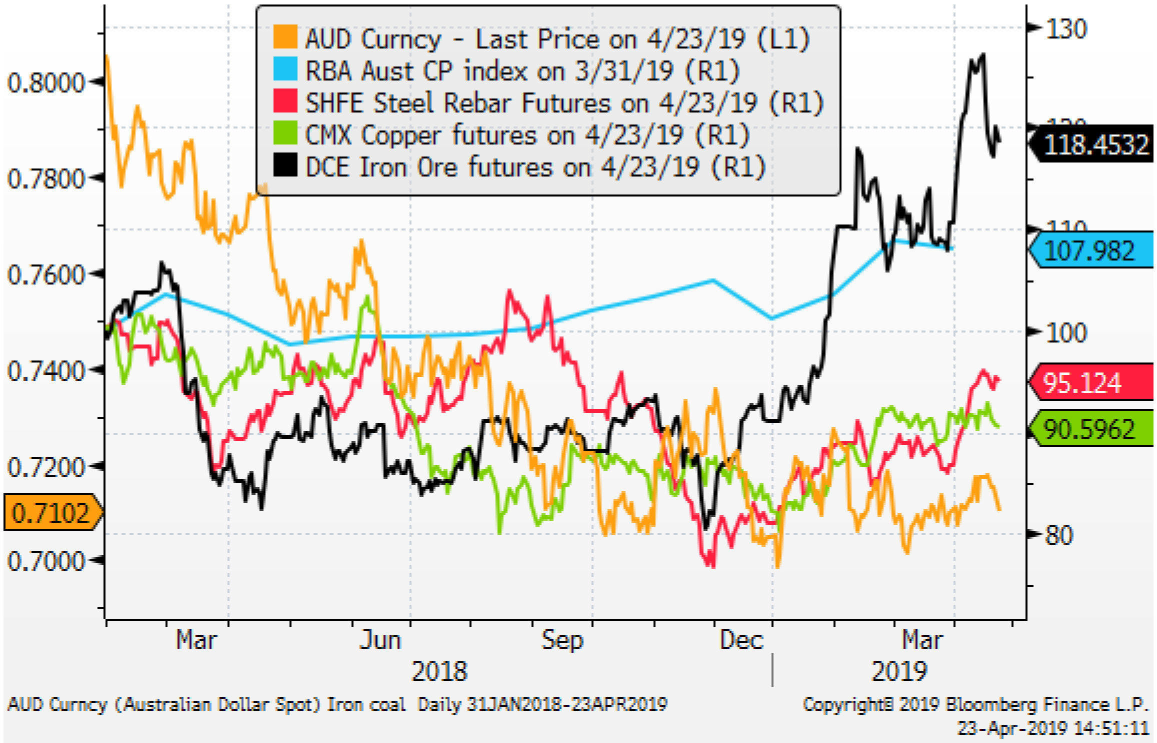


Major and safe haven currency performance

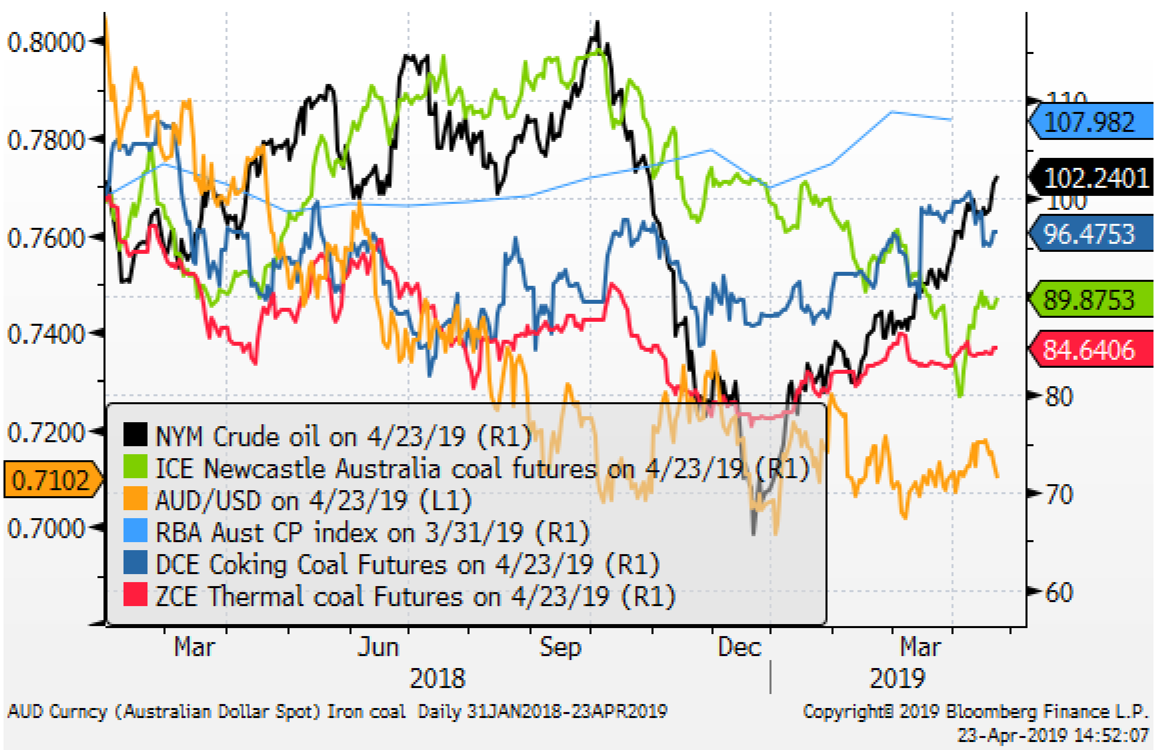




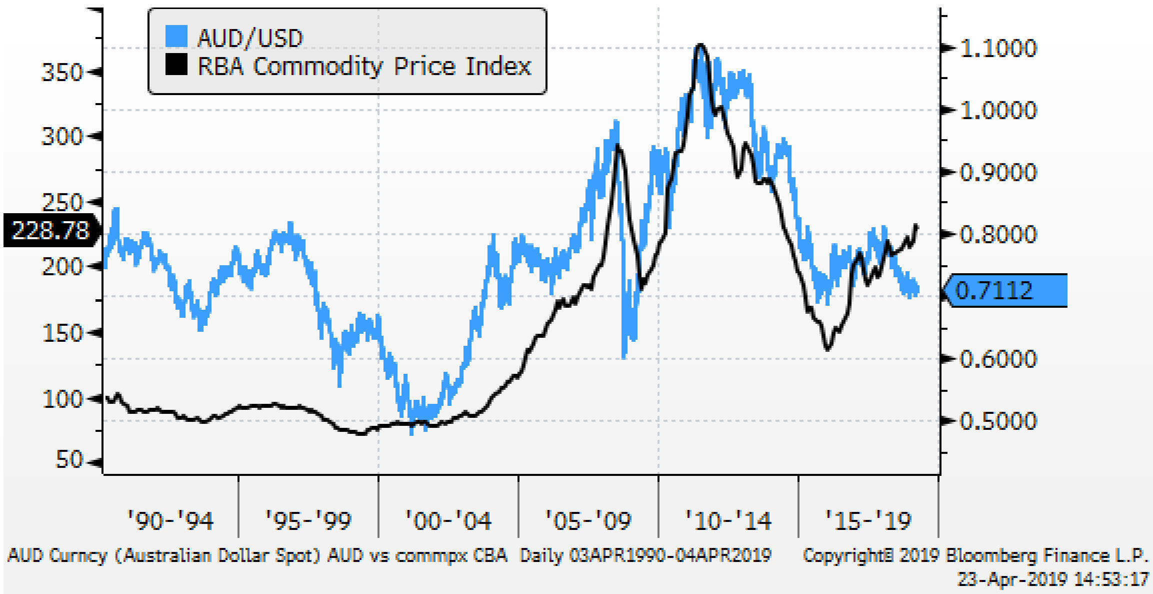
Metals prices – China steel and iron ore prices stronger this year, copper prices stable in recent months



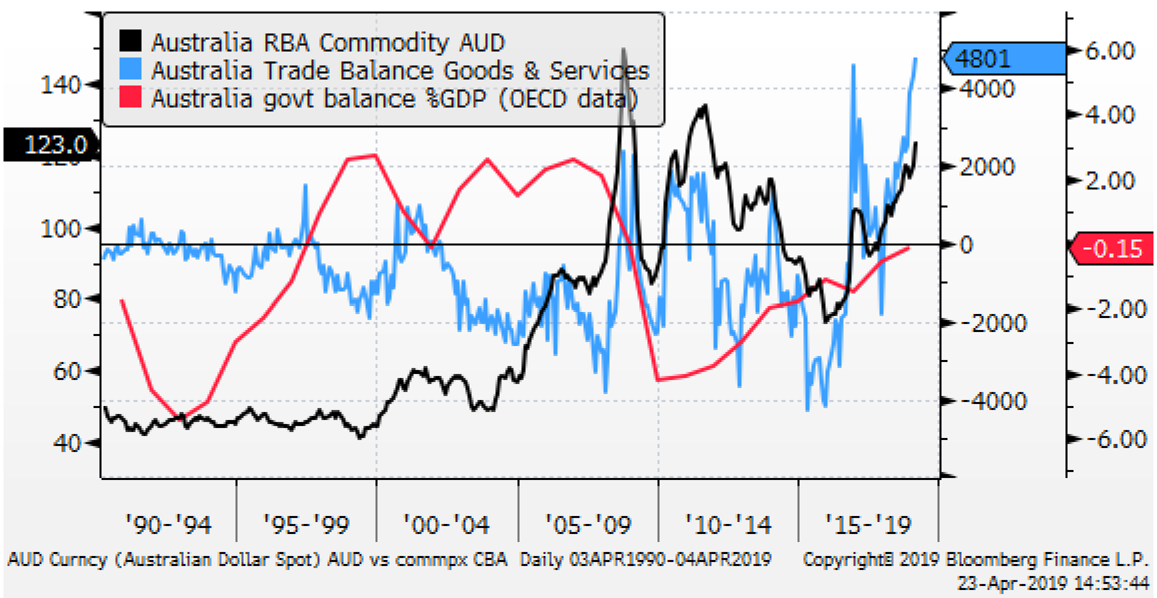
Energy prices – oil prices rebound strongly, coal prices more stable



AUD retreat is at odds with further strength in Australian commodities over the last year



Diverging AUD and commodities has helped push up the trade balance to a record surplus and has contributed to a stronger government budget position



Disclosure and Certification

- The author of this report often has positions in the currencies and securities referenced in the report at the time of publication, or plans to trade in these currencies and securities.
- The views expressed in this report accurately reflect the author's personal opinion about the referenced currencies and securities referenced and other subject matter.
- The report does not contain and is not based on any non-public, material information.
- The information in this report has been obtained from sources we believe to be reputable and accurate, but we have not independently checked or verified that information.
- This report is protected by copyright laws. Please do not republish, post or distribute in any way its contents without prior permission from our company.
- Our Company is incorporated and licensed in Australia to provide only general financial advice. Please see our financial services guide and terms and conditions for use of this report for more information.

Greg Gibbs,
Founder, Analyst and PM
Amplifying Global FX Capital Pty Ltd