Trade Idea – Foreign Exchange
Dollar downside
27th January 2017

Talked lower

- Next Friday, 2017’s first US nonfarm payroll report will be released and could determine the near term fate of the US Dollar. The widely monitored DXY dollar basket has moved 2.9% lower over the month, retracing a portion of the sharp 7.1% rally experienced in the fourth quarter of last year. A strong payroll figure could re-ignite rate hike expectations and put the US Federal Reserve’s (Fed) March meeting back into play (rate hike currently priced at around 20%*), while a weak slate could confirm predictions that the Fed will adopt a more dovish stance than is currently being suggested. We believe it is likely that the US Dollar has further room to run lower in the coming months as the Fed remains on the side-lines (i.e. does not hike rates in March) and extended speculative positioning unwinds. This is most likely to be witnessed against the GBP and EUR, as the JPY has already experienced a considerable correction and oil-related currencies remain subject to supply concerns.

- Rhetoric from Trump’s administration, specifically him and his Treasury secretary nominee, Steven Mnuchin, also has potential to weigh on the US Dollar from a sentiment perspective. Both figures have emphasised the detrimental effect of an “excessively strong US Dollar” on the wider American economy and further comments could add to bearish momentum currently surrounding the currency.

Overstretched and overdone

- Speculative futures positioning data suggests that net long US Dollar positions have moderated somewhat in recent weeks. However, gross long US Dollar positions remain considerably elevated and short positioning near record lows (see Figure 1), so further correction potential remains. Technically speaking, while momentum indicators turned lower for the US Dollar at the start of the year, they remain on an established downward trend and some way from bottoming. The EUR/USD is trading near its 38.2% Fibonacci retracement at 1.07, and any break could see it head towards its 100 daily moving average (DMA) of 1.082. Meanwhile, the GBP/USD recently broke through its 50 DMA and has potential to head towards its own 38.2% Fibonacci retracement at 1.28.

*All figures quoted are sourced from Bloomberg unless stated otherwise.
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