BANNOCKBURN GLOBAL FOREX, LLC

October FX outlook – More Central Banks and Politics

After dipping to new lows early in September, the USD recovered by the end of the month to finish generally a little higher. Support came from slightly increased expectations of Fed tightening by the end of the year following the latest Fed meeting and Yellen comments, and from some renewed positive sentiment on the potential stimulus from a Trump/Republican fiscal package after the Trump announcement of his plan. The EUR made marginal new highs early in the month following the ECB meeting and the indication that a tapering plan would be put in place in October, but lost a bit of support after the German election. GBP performed well as the Bank of England suggested a rate hike may not be too far away, while the CAD fell back after initial gains when the BoC suggested that further tightening was off the agenda for the moment.

Five-Year USD Index:

Outlook for October

1) US Fiscal / Monetary Policy

The next FOMC meeting isn't until November 1, and in any case there is no expectation that policy will be adjusted until the December meeting, although the November statement could prepare the market for a move. However, the recent Trump announcement of tax cut plans will refocus the market on fiscal policy and any potential monetary policy impact. But in practice it looks likely to be very hard to get the Trump proposals through Congress, and the risks may be towards renewed disappointment on the prospects for easier fiscal policy and consequently for tighter monetary policy.

2) ECB Meeting October 26

At the September meeting the ECB previewed October as the meeting at which they would announce their plan for the tapering of asset purchases in 2018. They have pledged to continue the current pace of purchases until the end of the year, but it would now be a big surprise if they didn't plan to end purchases by the end of 2018, with the market probably looking for purchases to end by mid-2018. Of course, the ECB will be at pains to point out that their policy remains very accommodative with rates unlikely to rise before 2019, and the comparison with the Fed is instructive given that the Fed started to raise rates at the end of 2015 and is now actually reversing QE by buying back assets from the market. So it may be that the tapering announcement proves underwhelming given that it has been so well flagged and that elsewhere monetary policy is actually being tightened (rather than being loosened less rapidly).

3) Brexit Negotiations / UK Monetary Policy / UK Politics

GBP benefitted through September from a more hawkish tone to the MPC minutes and general indications from various MPC members that a rate hike may not be too far away. The Brexit news has been more mixed, though May's Florence speech gained some positive responses, even from chief EU negotiator Michel Barnier, there are still no definitive agreements on anything. October starts with the UK Conservative Party conference, which could increase the UK's problems in Brexit negotiations as the divisions in the Conservative party may well be highlighted even if the party tries to stage manage the conference as usual. Prime Minister May is still generally seen as unlikely to remain leader until the next election, and the party conference may well be a platform for her potential challengers to stake their claim. The popular stance at the Conservative conference tends to be anti-Europe, so negotiations could receive a setback if right wingers gain support. The next Bank of England MPC meeting isn't until November 1, but with members indicating the potential for a rate hike "in the coming months" at the last meeting, speculation will develop through October on the potential for a move in November.

4) Japanese Election / North Korea

Abe has called an early election in Japan, ostensibly about economic policy, but a large enough victory for Abe would increase the chance of him passing constitutional reform which allows Japan to remilitarize. This is more important in the context of the heightened tension with North Korea in recent months especially since their firing of a missile over Japan. For markets, a convincing victory for Abe and steps towards remilitarization could heighten

Korean tensions.

Currency Outlooks

EUR/USD

After making a marginal new high after the ECB meeting at the beginning of September, EUR/USD fell back into a fairly narrow range below 1.20 for most of the month. While markets initially saw the lack of any explicit ECB protest about recent gains in EUR/USD as supportive for the EUR uptrend, gains beyond 1.20 proved unsustainable, and closer reading of the ECB comments did suggest that the strength of the EUR would, to some extent, limit the scope for ECB tapering in 2018. EUR/USD strength has been built on a combination of fading expectations of Fed tightening as US growth and inflation projections have been reduced, a loss of confidence in the ability of Trump to push through tax cuts and infrastructure spending, the recent resilience of the Eurozone economy and some USD weakness from geopolitical concerns surrounding North Korea. This last factor is likely to continue to marginally favor the EUR and other more risk negative/safe haven currencies when tensions increase, but if genuine risks of a bigger conflict emerge, the USD typically benefits. Markets will continue to monitor the data and fluctuating expectations of Fed and ECB policy, but it is hard to see a major impetus coming from the expected ECB announcement of tapering this month, as this has been so well flagged. The FOMC meeting on October 31/November 1 is unlikely to produce any change in policy, but could turn out to be a bigger influence by setting up market expectations for the December meeting, with the market currently pricing a Fed rate hike at around a 70% chance. Having failed to break convincingly above 1.20, the bias now may be towards some further consolidation towards 1.15.

Five-Year EUR/USD:

GBP/USD

GBP/USD strength through September rested mostly on the increase in market expectations of a Bank of England rate hike following the September MPC minutes and comments from Carney and others indicating an increased chance of a rate hike in the coming months. There was also some fading of Brexit concerns following May's Florence speech. However, at these levels GBP's downside risks have increased. A Bank of England rate hike still seems unlikely in November and even if the Bank does move, the relatively high level of UK inflation means UK real rates remain unattractive by international standards. The risks from Brexit are also two-way. Sentiment has improved a little in the last couple of weeks, but there are some risks of any progress being undermined by internal splits in the Conservative Party opening up following the party conference at the beginning of the month. Positioning is also less favorable, with net speculative positions in the futures markets now net long GBP for the first time since 2015. For GBP/USD, much will depend on the general trend in the USD, and renewed USD weakness could see a test of the 1.38/1.40 area, but such levels should be a very good medium term selling opportunity for GBP. In the run up to the end of the year a renewed move below 1.30 looks likely.

Five-Year GBP/USD:

USD/CAD

The CAD enjoyed brief sharp gains in September helped by general USD weakness and some strength in the oil price, but comments from BoC governor Poloz towards the end of the month triggered a reversal of CAD strength from the base near 1.20. Poloz didn't rule out a further rate hike this year, but suggested this may now be a fairly high bar to clear, as he wants to monitor the impact of the two rate hikes already seen. This suggests risks for

USD/CAD will now rest in part on Canadian data and the oil price, but probably mostly on fluctuations in expectations for the Fed. If the market reduces the 70% probability of Fed tightening currently in place for December, USD/CAD could break below 1.20 towards a technical target at 1.15. But this seems unlikely in the short run and a 1.21-1.27 range seems likely to contain the pair this month.

Five-Year USD/CAD:

USD/MXN

After softening early in the month, USD/MXN moved higher in the latter part of September as market expectations of Fed tightening by the end of the year increased. However, the downside risks to the MXN from Fed tightening are quite modest, given the MXN yield advantage. As long as the US economy is performing well and Trump protectionist policies aren't implemented, the MXN should be well supported. While general USD gains could see a move up to the 19.00 area this should be an effective cap in the short run. However, the 17.50-18.00 area now looks like good support.

Five-Year USD/MXN:

Bannockburn Global Forex, LLC is a boutique capital markets trading firm specializing in currency advisory and payment services. Our firm is purely client-oriented and our basic model is to combine expert counsel and pre-trade analytics with low-cost execution