

USD Seasonals, Funding Stress, And Risks Into Year-End

The USD has seen an impressive start to Q4 with broad month-to-date gains initially delivered by stronger than expected data and firming Fed expectations and subsequently driven by the violent period of risk aversion that has characterized much of the market tone over the past few weeks. USD seasonals are typically supportive into year-end as global investors' hedging demands lift the cost of USD borrowing over the 'turn' of the year. Tax reform-related USD repatriation, Fed policy normalization and the renewed divergence in the global growth narrative appear to be exacerbating seasonal funding pressures, posing some upside risk to the USD into November and early December. We acknowledge the material risk posed by other upcoming events including next week's U.S. mid-terms and the Trump-Xi meeting scheduled for the end of next month, however we feel that readers should—at minimum—be aware of the standard seasonal trading patterns for FX as we proceed through this critical period.

The USD has a well-defined seasonal profile that typically delivers meaningful Q1 strength, mid-year weakness through Q2-Q3 and a swift rally through much of Q4 into the period surrounding the December FOMC. This year's USD performance (according to the DXY) has been incredibly atypical as early weakness reflecting U.S. fiscal concerns (post tax reform/spending) was subsequently faded on the back of reform-related USD repatriation and a renewed divergence in the global growth narrative.

The USD has entered Q4 on the offensive, notching impressive gains through most of October on a combination of both fundamentals and sentiment. The performance has (finally) respected the seasonal trend, opening up the potential for additional near-term gains over the next month or so.

Year-end USD strength typically coincides with funding pressures related to global investors' hedging demands for calendar reporting and a general reluctance to lend USD over the 'turn' of the year. The USD shortage typically manifests itself via the swap market, with notable widening in the cross currency basis across most of the G10.

Post-crisis funding pressures were most acute in 2017 with notable blowouts in the basis for EUR, JPY and CHF. EUR basis has already started widening and is currently at slightly wider levels than recent post-crisis years. The story is similar for the CAD basis as well.

Short-term funding pressures have also been observed across other areas of the markets, with a notable widening in LIBOR-OIS reflecting higher unsecured funding rates as a result of the Fed's ongoing policy (and balance sheet) normalization.

In terms of the risk for FX, USDCAD appears vulnerable to near-term upside over the next few weeks. As with the USD, USDCAD has finally begun to trade in line with its seasonal trend with meaningful month-to-date gains in October. November has typically been a bullish month for USDCAD in the post crisis period, with gains in each of the past five Novembers and 8 out of the last 10, respectively delivering average gains of 1.0% and 1.3%. EUR fell in six of the last 10 Novembers for an average decline of 1.5%.

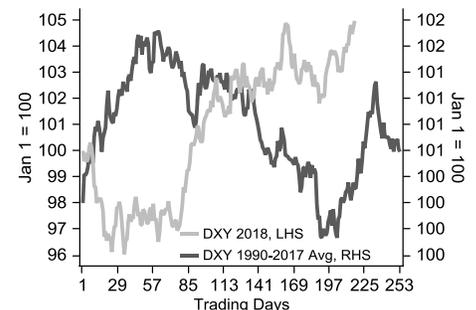
The coming event calendar is incredibly busy with considerable risk into and through next week's U.S. mid-terms as well as the Trump-Xi meeting scheduled for later next month. The President's rhetorical attacks on the Fed are an additional concern as market participants assess the recent tightening in financial conditions and consider the implications for both the November (8th) and December (19th) meetings.

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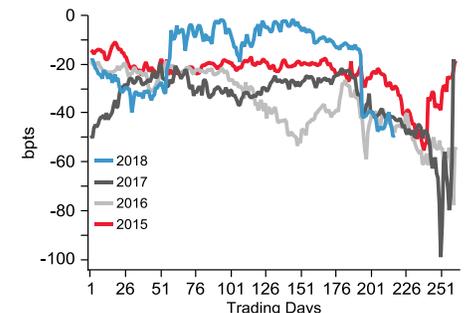
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DXY Ignores Seasonals Into Q4...



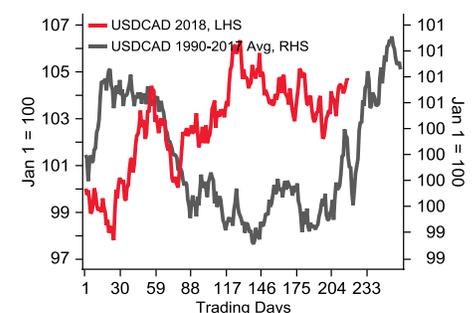
Source: Macrobond, Scotiabank FICC Strategy

EUR 3M Cross Currency Basis Swap



Source: Macrobond, Scotiabank FICC Strategy

USDCAD Also Ignored Seasonals Into Q4...



Source: Macrobond, Scotiabank FICC Strategy

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