Italy-German spreads hit multi-year high

There are signs of stress in the bond market. Italian yields surged yesterday, widening the spread over equivalent German debt to levels unseen in more than five years. What does it all mean for the euro?

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EUR: 10yr Italy-German spreads at multi-year high

The 10-year BTP-Bund spread hit a multi-year high yesterday after the EU Commission requested that the Italian government make changes to the draft budget (calling it an unprecedented deviation from EU rules). While a clear non-positive for the euro, the spillover into the common currency has been fairly limited (EUR/USD still trading not far away from 1.1500) partly because the disagreement over the path of the Italian budget has been widely expected (in addition to the downgrade by Moody's later this month). In other words, a fair degree of negative news relating to Italy seems to be in the price, hence the relatively mild pace of EUR decline.

USD: Verbal intervention stabilising EM Asia FX

Emerging markets and G10 risk currencies largely stabilised overnight despite somewhat weaker than expected Chinese 3Q GDP (decelerating to 6.5% from 6.6% in the previous quarter), with sentiment helped by comments from Chinese authorities about keeping risk under control. With a fairly quiet day on the data front today, we expect EM Asia FX stability to spill over into the

European and US trading sessions.

CAD: Flat monthly CPI won't derail rate hike

Our economists expect a flat monthly CPI figure, with the rally in oil prices keeping price levels neutral. The YoY reading is set to remain well above the 2% target (at 2.6% YoY). Any surprises to the upside or downside are unlikely to deter the Bank of Canada from hiking later this month (which is 90% priced in given that this is the last chance in 2018 for it to make a rate decision in tandem with the release of its quarterly monetary policy report – see BoC Preview). Still, a downside surprise may see a slightly negative reaction in the Canadian dollar as doubts creep in. Look for a largely neutral reaction in CAD

PLN: Another sub-consensus reading

Our economists expect September retail sales in Poland to follow this week's sub-consensus trend of industrial production and wages and print below market expectations (ING 7.0% YoY, market 8.1%). While the monthly activity data from 3Q18 still suggests GDP growth of close to 5% YoY, given the worsening of nearly all confidence indicators, a slowdown in the 4Q is the most likely scenario. We continue to look for a fairly limited spillover from the domestic data points (or market expectations of the central bank rate path) into the Polish zloty, with EUR/PLN currently being driven by the general risk environment. Indeed, EUR/PLN has been immune to the recent decline in short-end rate spreads.