

EUR: Cheap for a reason

We think the euro will underperform as Italy refuses to back down over its Budget and questions swirl about the timing of ECB normalisation



Source: Shutterstock

➔ USD: Rate spreads favour the dollar within G10

FX markets will be consolidating ahead of Wednesday's results of the US mid-terms, where we see [a binary outcome for the dollar](#). Before that, markets will today be contemplating what the reimposition of US sanctions means for world markets. One point of pressure is between the US and Europe, where Washington's policy of 'maximum pressure' on Iran wants to see Iranian banks excluded from SWIFT, a policy which Europe rejects. Elsewhere, IIF data shows investors returned to emerging market equities (particularly Asia) late last week. While EM equity valuations are undoubtedly low, we expect investors to be cautious about a substantial re-allocation away from the US, given: i) US mid-terms could deliver some surprise dollar strength, ii) US rates could move higher still and iii) the chances of a meaningful US-China trade deal at the end of November are highly uncertain. We see the dollar holding recent gains against the low-yielders and for those attempting to re-position for some carry in high yield EM, positions funded out of euro or Japanese yen could prove popular. The US dollar index could well trade a 96.25-96.75 range into the US mid-term results.

⬇ EUR: Rate spreads push to new wides

Two-year EUR: USD interest rate differentials continue to push to new wides. A fresh story here is a report that the ECB may need to re-introduce TLTROs (Targeted longer-term refinancing operations) in 2019 to avoid refinancing pressures, particular for Italian banks. That would add to the narrative of ECB monetary normalisation being delayed. For today, expect to hear more bearish remarks on Italy – this time from eurozone Finance Ministers backing the European Commission's rejection of Italy's proposed budget. We see the EUR underperforming on the crosses near-term and against EUR/USD, we could see consolidation in a relatively narrow 1.1360-1.1420 range short term.

⬆ GBP: A little outperformance versus the EUR may be due

The latest Brexit news appears mildly constructive for the pound, with talk of Prime Minister Theresa May trying to pitch another make-or-break deal to her cabinet tomorrow. Any news this week that the EU would hold a Brexit summit after all in November would be greeted positively. GBP/USD appears somewhat of a lottery this week depending on the US mid-terms, but we think EUR/GBP could be embarking on a sustainable bear trend – largely on the back of the deteriorating EUR outlook. 0.8800 could cap now, before EUR/GBP makes a run at 0.8620.

➡ ZAR: Interest in yield?

We're not big fans of emerging markets right now because of trade tension, China slowdown risk and rising US rates. Yet we acknowledge there may be a brief window for carry to do well (e.g. in the Turkish lira or South African rand). USD/ZAR is threatening some big support in the 14.00/14.20 area and EUR/ZAR might have an opportunity to trade sub 16.

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