Making Italy Great Again..?

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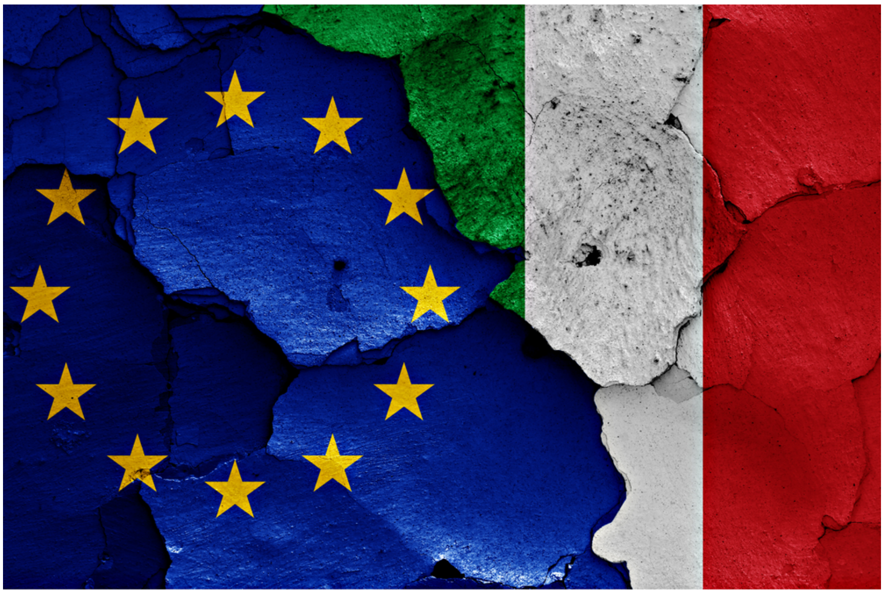

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USD: Wary of drawing fundamental stories with quarter-end flows in play

The US data flow sees August core PCE inflation today; our economists are looking for 2.0% year-on-year in line with consensus. The dollar retains a bid bias – largely on the back of negative stories elsewhere but also potential quarter-end effects (note USD/JPY's move to a 2018-high at 113.50/60 may be partly reflective of this).

EUR: 2.4% deficit may Make Italy Great Again, risks making the euro worse first

In what is being called the 'People's Budget', the Italian ruling parties managed to agree a 2.4% fiscal deficit for 2019 – a much more expansionary budget that not only risks some pushback from the European Commission, but also may risk seeing both ratings agencies and investors question the Italian government's debt sustainability. Indeed, a deficit less than 2.0% was seen in markets as the line in the sand for a fiscally responsible budget; should Italy press ahead with a 2.4% fiscal deficit (reports suggest this may not be set in stone) – then we could easily see the 'Tria put' that has propped up the Italian bond market disappear. While we think any widening in Italian swap spreads could keep a lid on the euro in the near-term, any major negative spillover rests on whether we see greater redenomination risks (i.e. noise over 'mini-BOTs' or 'Italexit'). Given the change in sentiment over summer, we are nowhere near pricing in these risks – and prefer to see the Italian budget debate as a headwind (rather than an active drag) to the euro. What may lend a bit of support to the euro today is some 'vigorous' eurozone inflation data; following the big positive surprise in German CPI yesterday, there are upside risks to headline eurozone CPI (2.1% expected). But the focus will be on core CPI (1.1% expected)– a positive surprise here could help EUR/USD close above 1.16.

GBP: Risks of a hat-trick of GBP-negative PM May Tory conference speeches...

It's a fairly action-packed day for the pound ahead of this weekend's Tory Party Conference – a pivotal one, to say the least, for Prime Minister Theresa May. But ahead of this, we have the final release of 2Q UK GDP (which remember came in at a buoyant +0.4% quarter-on-quarter in the first release) – as well as possible headline risks stemming from comments by Deputy Governor Dave Ramsden (speech at 1420 BST). While we remain constructive on the big picture outlook for GBP/USD – and see 1.40 at the turn of the year – it's difficult to ignore the potential downside risks stemming from UK politics over the coming week. Indeed, GBP has traded with a negative bias in and around the last two Tory party conferences (on average GBP/USD has fallen around 1.0% after May's prior conference speeches). We wouldn't be surprised to see a hat-trick of GBP sell-offs if the Prime Minister has another difficult conference. GBP/USD at 1.2985 (50-day moving average) a key sentiment gauge.

CAD: Poloz all but confirms an Oct BoC hike giving CAD some Nafta respite

July Canadian GDP and August industrial production data are likely to have some impact on the Canadian dollar today; as our economists note, a slight improvement in growth during July should be enough to see the Bank of Canada hike rates in October. But with Nafta talks failing to yield any breakthrough, the outlook for growth remains uncertain. Movements in USD/CAD have been wildly out of sync with Canadian fundamentals for a while now – with the pair largely being driven by (1) Nafta sentiment and (2) USD sentiment (global factors). BoC Governor Stephen Poloz said on Thursday that uncertainty "does not mean keeping interest rates on hold until inflation momentum begins to build" and that the Bank will "continue to follow a gradual approach to raising interest rates." Bar any major GDP miss today, we see the balance of risks tilted towards USD/CAD moving back sub 1.30.

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