Catalyst for euro upside in sight

ECB President Mario Draghi's comments yesterday on the "relatively vigorous pick up in underlying inflation" boosted the euro. But we think it's still too early to position for the ECB-induced euro upside at this point

USD: Better sentiment, but a fading rebound in EM FX

Despite more optimism among market participants about the potential shift in direction for emerging market FX and the dollar, the relief rally largely stalled this week. In the EM space, only a handful of currencies have actually been up against the US dollar this week (with only the Turkish lira and rouble posting meaningful gains). The same is the case for G10 FX which is, on average, down against the USD this week. While the EM environment looks to have stabilised, the rise in US Treasury yields (10-year UST now close to 3.10%), as well as the threat of further escalation in trade wars, still pose headwinds for a more persistent EM FX rebound.

EUR: The second step on ECB policy normalisation in sight

President Mario Draghi's comments yesterday on the "relatively vigorous pick up in underlying inflation" boosted the euro, with EUR/USD briefly breaking above the 1.1800. The second step in the ECB policy normalisation (hiking the deposit rate following the already well-telegraphed end of quantitative easing) and its positive impact on EUR is one of the cornerstones of our bullish

EUR/USD 2019 forecast. Yet we feel it may still be too early to position for the ECB-induced euro upside at this point. We expect the ECB factor to provide a boost to the euro early next year, which would coincide with the market front-running the ECB hike two to three quarters ahead (as was the case with QE tapering). For now, such comments/signalling from the ECB should put a soft floor under the EUR/USD.

NOK: More details on the dovish hike

Following the dovish hike from the Norges Bank last week, the focus today will be on Governor Øystein Olsen's speech. We don't expect much deviation from the tone of the inflation report, but think he may provide more clarity on the (in)consistency between the downward revision to the interest rate forecast vs the upward revision to GDP and CPI. We expect EUR/NOK to remain supported as the stabilising risk environment and higher oil prices should be positive for the currency, at the margin.

PLN: Externally driven

The Polish August unemployment reading should have virtually no effect on the Polish zloty (PLN). We currently see PLN as purely externally driven with neither the EU-Poland stand-off nor the National Bank of Poland providing a catalyst for meaningful zloty price action. On the former, last week's EC decision to sue the PiS for undermining the independence of courts had a limited impact on PLN. On the former, although ECB President Draghi's comments yesterday led to some hawkish re-pricing of the market's NBP rate outlook, we expect the upcoming decline in Polish CPI to pour cold water over such expectations. Rather, PLN should be currently viewed as a risk / extended EUR/USD play.