

FX: Bracing for Italy's no confidence vote

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Italian Prime Minister,
Giuseppe Conte

➔ USD: EM FX fails to benefit from temporary stabilisation in risk sentiment

While stock markets got a lift from the US government's decision to delay restrictions on Huawei by a further 90 days and hopes for German fiscal stimulus, the spillover into higher beta and emerging market FX was rather limited, with the pro-cyclical currencies remaining under pressure. This is likely due to low investor conviction on the rebound in global economic growth, the still fair degree of trade war uncertainty and the view that a resolution to the trade war would translate into a less dovish Fed (ie, no need to cut rates), which in turn, would mean a stronger US dollar (and weaker EM FX). The focus remains on the upcoming Jackson Hole symposium later this week and market hopes for hints at further monetary easing.

⬇ EUR: Gearing up for the no confidence vote in Italy

The possible success of the no confidence vote in Italy today (or Prime Minister Giuseppe Conte stepping down of his own accord) could push EUR/USD towards/below the psychological 1.1000 level today, though it remains to be seen whether this would translate into a new election (likely in October) or an alternative government without the League. While the former currently seems to

be the most negative outcome for the euro ([see Three political scenarios for Italy](#)), EUR/USD still may not slip meaningfully and persistently below the 1.1000 level in response. This is because the negative spillover into the euro from periods of political uncertainty in Europe has been somewhat limited (though still negative) over the past year.

⬇️ **GBP: Only a temporary respite for the battered pound**

EUR/GBP halted its decline and has remained above the 0.9100 level. As is the case for the FX spot, we have seen some correction in the options market, with EUR/GBP risk reversals and implied volatility declining from early August highs. However, with the negative headline news likely to return soon (Prime Minister Boris Johnson's engagement with EU leaders this week – and his latest insistence on the need to renegotiate the Irish backstop – and Parliament returning from recess in early September), spikes in GBP should continue to be shortlived.

⬇️ **PLN: Improving domestic data no respite for the zloty**

Our economists expect the Polish labour market to recover after a very weak June. July wages should increase by 1.5% to 6.8% year-on-year. Yet the effect on the Polish zloty should be fairly limited as the overriding driver of PLN is currently: (a) the FX mortgage story; and (b) challenging environment for EM FX. We continue to see upside risks to EUR/PLN with the cross eyeing the 4.40 level in coming days and weeks. The possible success of the no confidence vote in Italy today would also be a negative for PLN (as well as for other central and eastern European FX).