

## FX: Caution ahead of 'Super Political Sunday'

The forthcoming Italian election, key Brexit speeches and Fed Chair Jerome Powell's testimony to the House will drive FX markets this week



Source: istock

### USD: Hard to see Fed Chair flipping the policy script and lifting the dollar

The highlight of the week will be new Fed Chair Jerome Powell's testimony to the House Financial Services Committee on Tuesday. We expect him to echo the tone of the recent minutes and cement expectations of three Fed rate hikes this year. It looks too early for any hints of extra tightening at this stage. US data should be mixed with durable goods orders a little softer, but manufacturing ISM quite strong. Overall, we think the Fed tightening cycle looks fairly priced now and doubt the dollar can gain much further benefit from positive Fed rhetoric.

## EUR: Markets may be underestimating risks from ‘Super Political Sunday’

The story for the euro this week is one of caution as markets shift their focus to the political equivalent of ‘Super Sunday’ this weekend (4 Mar) – with both the [Italian elections](#) and the SPD vote on the Grand Coalition on the same day. We think the market may be underestimating the risks here – especially given that the EUR’s pro-cyclical and portfolio inflow-driven rally could run out of steam if political risks stay slightly elevated in the near-term. On the data front, we’ll get our first look at Feb EZ inflation (Wed); our team thinks prices will remain flat at best and this is unlikely to spur any further ECB tightening sentiment. We see politically-induced downside risks for EUR/USD this week towards 1.2100/30.

## GBP: Moving from dystopia to normality but expect a noisy week of speeches

Anyone that has watched the film Mad Max: Fury Road – and we suspect the Brexit Secretary David Davis may be a fan here following his reference-riddled speech last week – will know that it ends with the quote ‘Where must we go... we who wander this Wasteland in search of our better selves?’. In a way, that pretty much encapsulates our GBP outlook right now (with FX markets at times feeling like an enigmatic wilderness). It’s clear to us that the weak and almost ‘half-life’ like pound is looking for any positive reason to transform into a better version of its self, with the currency’s resilience of late indicative of a different Brexit trading environment relative to the more dystopian-like one observed over 2017. Part of this new environment is seeing GBP investors opting to trade off Brexit facts rather than Brexit speculation – with the latest CFTC positioning data showing that real money investors did not add to their net short GBP bets, despite the prospect of heightened Brexit uncertainty in the coming weeks.

Such context is important ahead of what is seemingly a pivotal week of Brexit speeches for GBP markets – with both opposition Labour leader Jeremy Corbyn (today) and Prime Minister Theresa May (Friday) set to lay out their respective visions for the future UK-EU trading relationship. ‘Customs union’ will be the buzzword of the week and it’ll be interesting to see whether Labour’s position of ‘full tariff-free’ access to EU markets – which would be the effective consensus within the House of Commons – would force the PM to seek a similar free-trade agreement. Still, while one can expect a lot of Brexit huffing and puffing this week from UK politicians, real money GBP investors will wait for the facts – and here the European Commission’s response to PM May’s speech may be equally important. Expect some choppy GBP trading – with the risks modestly tilted to the upside. GBP/USD supported above 1.40; EUR/GBP risks to 0.87 this week.

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