

FX Daily: Over-complacent GBP at risk as Brexit talks resume

Sterling's recent good performance and resilience to grim economic data has likely relied on the Brexit story being put on the backburner by investors. That could be about to change as negotiations re-start



⬇️ USD: Haven demand still drifting away from the dollar

The dollar is extending its broad-based bearish momentum. The Federal Reserve's Empire State manufacturing index slump yesterday came in stark contrast with encouraging signs from the US housing market (which should be confirmed by housing starts figures today), while the mix of geopolitical tensions (US-China spat and protests in Belarus) are still failing to offer support to the dollar as most safe-haven flows are being absorbed by the Japanese yen. Today is going to be a quiet day in terms of data releases, with investors likely keeping their eyes open on any developments in the key market-moving threads: from geopolitical tensions to any (unlikely) advancement in the US bipartisan stimulus talks. All in all, with a bearish trend consolidating, the dollar appears to be hoping for a less-dovish-than-expected message in the Fed minutes due tomorrow. We doubt that the release will offer enough push to the USD to invert the trend and any potential USD-positive effect may be short-lived on the back of an opportunistic sell-the-rally approach on the dollar.

📈 EUR: Still a dollar story for EUR/USD

EUR/USD remains largely driven by the dollar leg ahead of the main EUR-specific catalyst- the eurozone PMIs- at the end of the week. Today's speech by European Central Bank Vice President Luis De Guindos may attract some interest ahead of the Bank's minutes to be released on Thursday, but the recent cautious approach by the ECB suggests monetary policy is unlikely to take centre stage for the euro any time soon.

➡ GBP: Back to the Brexit table, hardly any good news for sterling

Today, UK and EU negotiators kickstart another round of talks on a trade deal that would regulate the departure of the UK from the bloc. Sterling's recent good performance and resilience to grim economic data has likely relied on the Brexit story being put on the back burner by investors. With a few sticking points where the two sides still appear far apart (above all, the level competitive playing field and access to UK fishing waters), the newsflow around the negotiations may well get worse before it gets better. In particular, we see a non-negligible risk of markets starting to price back in a no-deal outcome, considering the effective early-October deadline for reaching an agreement is approaching and the two sides are set to deal with new spikes of Covid-19 contagion. Our base case remains for a deal to be ultimately reached, but we expect the over-complacent GBP (which is now also less protected to the downside given [positioning has moved to neutral](#)) to face increasing Brexit-related stress in the coming weeks, making it a possible key laggard in the G10 space.

📈 \$-bloc: Growing divergence

G10 commodity currencies are showing some diverging dynamics on the back of domestic factors. The New Zealand dollar continues to lag its peers, the Australian and Canadian dollars, as investors appear to be gradually pricing in a move by the Reserve Bank of New Zealand into negative rates, and a fresh lockdown in Auckland is also weighing on the currency. Still, we expect NZD to find a floor soon as some investors may doubt that the RBNZ will effectively cut again. AUD, instead, is benefiting from some fresh hopes of re-opening in Victoria, while the Reserve Bank of Australia's downbeat tone on the economic recovery shown in the minutes overnight had already been priced in after Governor Philip Lowe's speech last week, and left little mark on AUD. CAD is retaining good momentum – largely thanks to lingering good resilience in oil prices – despite the resignation of Canadian Finance Minister Bill Morneau yesterday.

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