

FX: Italian political risk hints at weaker EUR/CHF

Trade tensions are inevitably bound to remain the primary driver of market sentiment in the days ahead, but expect an eventful week in terms of Italian political developments, which may continue to fuel upside pressure on BTP rates



People at the beach ready the beach party

Source: Shutterstock

➔ USD: Trade tensions remain the primary driver

The week starts without major data releases and with thinner liquidity as some Asian markets are closed for a holiday. Trade tensions are inevitably bound to remain the primary driver of markets sentiment in the days ahead, in particular after increasing speculation that the negotiations scheduled for September will be called off. The People's Bank of China's CNY fixing has been moving slightly outside of investors' radar but the risk of China allowing a further sharp depreciation of its currency is anything but unwarranted and would likely signal the start of a "currency war" with the US. Looking at the US side, the [probability of an FX intervention](#) by the US Treasury is relatively low, but we expect the markets to remain quite sensitive to any intervention-related news. Except for CPI numbers tomorrow and retail sales on Thursday, the dollar should continue to be driven mostly by external geopolitical developments this week.

[US FX intervention: What are the chances?](#)

📌 EUR: Italy could fuel more EUR/CHF downside

After deputy prime minister Matteo Salvini broke the governing coalition last week, [we highlighted three possible political scenarios for Italy](#), also noting how the balance of risks for the EUR and Italian bonds was likely tilted to the downside moving ahead. During the weekend, former prime minister Matteo Renzi (of the Democratic Party) showed interest in forming a coalition with the Five Star to deliver the 2020 budget and avert a VAT tax hike. This option – which may provide some short-term respite to market concerns – has been fiercely opposed by the current Democratic leader (Nicola Zingaretti) and a large part of Democratic MPs. Nonetheless, Renzi still has a number of followers in the parliament and may ultimately have enough seats to govern with Five Stars. It would remain to be seen whether Five Stars would accept the deal.

All in all, we expect an eventful week in terms of Italian political developments, which may continue to fuel upside pressure on BTP rates. While EUR/USD will probably remain broadly attached to the 1.12 level. For now, we see room for more EUR/CHF downside towards the 1.08 region.

[Three political scenarios for Italy with FX and rates implications](#)

📌 GBP: Elections uncertainty weighing on the pound

As prime minister Johnson's revealed additional spending plans, speculation that he is preparing for new election has mounted. Uncertainty, whether elections will take place before or after the exit from the EU, is likely to keep weighing on GBP

📌 NOK: More volatility ahead of Norges Bank meeting this week

Despite volatility in the FX markets slowing in line with stabilising risk sentiment, NOK has continued to display major swings towards the end of last week. In a [recent publication](#), we highlighted how the high sensitivity of the Norwegian krone to risk aversion leaves the fate of the currency in the hands of the Norges Bank and a recovery in oil prices.

The Norges Bank will meet this Thursday, and NOK bulls are likely to be in desperate need of confirmation of the bank's intent to keep tightening monetary policy. On the oil side, Saudi Arabia's intervention to halt the slump in prices has been providing some respite, although demand-related concerns linger. Any developments here – along with trade-war-related news – will likely have a significant impact on NOK in the days before the central bank meeting. For now, we may see EUR/NOK continue to pare recent losses and revert towards 10.00.

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