FX: It's the wrong time for carry

Global equity markets have had a good year despite slowing growth and trade uncertainty. But stocks are typically one of the last asset classes to turn in the cycle and this shoe may drop later this year. Lower equities typically coincide with higher levels of volatility, undermining one of the key inputs to the carry trade

falling stocks

USD: It's hard to argue against the dollar in the short term

It seems quite strange that most global equity markets have had a good year – even as trade uncertainties have grown and inverted yield curves increasingly point towards stalling/recessionary levels of growth. Typically, however, equity markets are one of the last asset classes to turn in the cycle and this shoe may drop later this year if corporate earnings guidance and profits re-align with expectations of activity. Lower equities typically coincide with higher levels of volatility, undermining one of the key inputs to the carry trade. Additionally with so many event risks, such as trade escalation and European politics, we suspect investors will increasingly focus on capital preservation rather than the search for yield. This all points to continued support for the dollar, unless the trade conflict is resolved or the Federal Reserve surprises with a much more aggressive easing profile – neither of which looks imminent. In our latest FX talking edition, we therefore take a defensive view in the currency markets over the next one to three months, seeing the dollar bid versus emerging markets and the Japanese yen subject to outperformance, if the deterioration in trade and activity takes its toll on equity markets. For today, the calendar is quiet and the dollar index should stay bid in a 97.50-98.50 range.

EUR: All the good news quickly prices in Italy

News that Italy can (probably) avoid early elections has been welcomed by the bond market and narrowed the 10-year BTP-Bund spread into levels last seen last summer. We'll find out this morning whether the Democratic Party (PD) and the Five Star Movement are happy to form a government – although this is by no means assured. It's unclear whether spread narrowing has much further to run and heavy Italian supply later this week won't help either – all suggesting the euro won't get much of an uplift from any Italian news. Instead, the escalation in trade wars merely looks to extend the slowdown in manufacturing, depressing European growth still further. Like all activity currencies, the euro looks soft and could break down to new lows at any time. EUR/USD support at 1.1025/50 looks vulnerable.

GBP: Brief support as legislative efforts build to block no-deal

Rather than a no-confidence vote in the Johnson government, the return of parliament next Tuesday looks set to see an anti No-Deal coalition pursue the legislative route – trying to gain time in the parliamentary agenda for an emergency debate. This may trigger a brief reprieve in GBP selling, although we're still wary that EUR/GBP trades as high as 0.95 into October. For today, any suggestion that the legislative route has legs could see EUR/GBP break under 0.90.

ARS: Argentina keeps Latam on the back foot

The Argentine peso softened again yesterday as the market awaits news from the IMF's visit. While we expect the next IMF tranche to be approved, the outlook for the ARS remains dim and high inflation looks set to send USD/ARS to 70 on a three-month view.

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