FX: Winners and losers in the weak euro story

ECB's Olli Rehn's remarks exacerbated the already battered sentiment for the euro, which we think will continue to weaken against the Swiss franc. In our view, EUR/CHF has the potential to edge below 1.08 in the coming weeks. But keep an eye out for June export data today for any signs of a slowdown in eurozone exports thanks to the trade war

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USD: Beyond the inversion

Some positive signals from July retail sales and New York Fed Empire index helped to partly cast out fears of a US recession and stabilise equity markets yesterday.

As highlighted by our US economist, we are reluctant to attach a high probability of an imminent recession in the US, despite the recent inversion in the yield curve. On the trade side, President Trump confirmed that he has a call scheduled "very soon" with Chinese leader Xi Jinping. Despite the two parties still appearing quite far from reaching a trade deal, the news may prompt further stabilisation in risk sentiment today. In turn, we expect a broadly stable USD as we enter the weekend, with the University of Michigan sentiment indicator the only scheduled release and unlikely to prompt major market moves.

The self-fulfilling threat of an inverted yield curve

EUR: Expect more weakness against the CHF

EUR/USD came under pressure yesterday and touched 1.11 after comments by ECB's rate-setting committee member Olli Rehn fostered expectations that the Bank will deliver a heavy package of monetary easing in September. Indeed, market expectations about the September meeting are already aggressively on the dovish side: 18bp of easing is priced in, close to our call for a 20bp cut. Rehn's remarks exacerbated the existing battered sentiment on EUR after the weak data-flow this week, but EUR/USD may have run short of more downside drivers today. In turn, the 1.110 level could play as a fairly solid support on the day.

By contrast, the euro may continue to weaken against CHF, which should benefit from three key factors including ECB's easing expectations, escalating trade tensions; and rising political uncertainty in Italy. In our view, EUR/CHF has the potential to edge below 1.08 in the coming weeks. In terms of economic releases, investors may want to keep an eye on June export data today, mainly with the aim of spotting any slowdown in eurozone exports caused by global trade tensions.

Italian politics: What now?

GBP: Watch for a correction after the deceptive rally

Sterling had an unusual positive day yesterday, mainly benefiting from some position-squaring related upside pressure and a weaker euro. We think any rally in GBP is likely to be short-lived as the lingering uncertainty about Brexit should discourage investors from jumping on long-sterling positions to play any rebound in risk appetite.

Hence, we look for EUR/GBP to move back above the 0.9200 level in the coming days.

EM FX: CEE gains to stay limited

The dovish comments by policymaker Olli Rehn had a positive spill-over effect on global risk sentiment, providing some respite to emerging market FX. We expect CEE currencies to remain the underperformers vs other EM regions as the revival in risk appetite is likely to be accompanied by lower EUR/USD (a by-product of dovish ECB expectations).

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com