Global FX: Turning into a bloodbath

Chinese equity markets and the yuan play catch-up to last week's turmoil in global markets – with both sliding lower despite another 100 basis point RRR cut

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USD: Chinese markets play catch-up to last week's global turmoil

The return of Chinese financial markets after the Golden Week holiday is setting the tone for the rest of the world in a week that begins with the US, Canada and Japan all out on holiday today. To a large degree, both Chinese equity markets and the Chinese yuan are playing catch-up to last week's turmoil in global markets – with both sliding lower despite the People's Bank of China returning with another targeted cut in the reserve requirement ratio (by 100 basis points). The PBoC also fixed USD/CNY just shy of the 6.90 level (the reference rate today was 6.8957) – which was broadly in line with our expectations given the yield-driven moves seen in the dollar last week. Yet, the spillover effects to other CNY-sensitive currencies has been fairly limited; we usually view the Australian dollar as a litmus test here and the currency is trading fairly neutral this morning. This corroborates our view of a 'catch-up' theme in Chinese markets – and we think the PBoC not opting to fix USD/CNY anything north of 6.90 might have provided some minor relief – amid a myriad of woes – to risky assets. Our G10 FX Week Ahead notes that the stock market rout may keep high-beta FX under pressure.

EUR: Moment of truth for the Italian budget & German macro data

While the Italian budget noise continues to be unhelpful for the euro – our base case is for 10-year BTP/Bund spreads to broadly hold in the upper half of the 200-300bp range over the coming months. This takes into account a likely one-notch downgrade from Moody's. If S&P also downgrades Italy's credit rating –and not just the outlook as our base case assumes – a sustained break above 300 basis points might unfold. In the absence of this, expect EUR/USD to trade fairly neutral around the 1.15 level with German data and the ECB minutes to note this week.

JPY: Tentatively calling a top in USD/JPY as bond rout turns to stock rout

While rising US bond yields had taken USD/JPY up to an intraday high of 1.1455 earlier last week, the upward trend channel has stalled – with the pair moving back below 114. Part of the reason is the broad sell-off in global tech stocks – in particular the Nasdaq – which may well have fuelled yen repatriation flows. We are tentatively inclined to say that this may be a short-term top for USD/JPY – but will need to see a sustained move below 1.1330/50 to provide confirmation of this. External risks ahead include ongoing US stock market woes, any further negative US-China trade war rhetoric, negative global growth sentiment from the IMF World Economic Outlook report (Tuesday). It doesn't look pretty – and the yen should win here.

BRL: Bolsonaro win could see move to 3.70 but a lot of good news priced in

After the first round of Brazil's Presidential elections, ING's Gustavo Rangel notes that the results diverged materially from the current polls – with a strong anti-establishment wave helping unseat many traditional forces. In the presidential race, right-leaning candidate Jair Bolsonaro led left-leaning runner-up Fernando Haddad by 17pts. Bolsonaro's strong momentum gives him an edge, but a more moderate Haddad also bodes well for local assets. We continue to expect the Brazilian real (BRL) to trade with a constructive (but yet volatile) bias, with some risk of USD/BRL temporarily dropping below our year-end forecast of 3.70. But given the sharp rally that has already occurred, the room for additional BRL appreciation seems more limited. The second round of voting takes place on 28 October and we note a final election call remains difficult – expect some policy moderation from both candidates.