Saved by the Nafta bell

Finally some good news on the trade front. A trilateral trade deal between the US, Canada and Mexico has been agreed in principle, helping to lift the Canadian dollar and Mexican peso. However, the spillover effects have been disappointing

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USD: Positive effects of a Nafta 2.0 deal muted by softer China data

We've rarely said this in 2018, but global markets have started the week with a bit of good news when it comes to US trade policy. We doubt anyone was truly expecting yesterday's Nafta renegotiation deadline to be upheld; however, it seems that a trilateral trade deal between the US, Canada and Mexico has been agreed in principle by negotiating officials. While this has provided some good news for the Canadian dollar and Mexican peso, the spillover effects into broader global risk sentiment have been fairly disappointing – with high-beta G10 currencies like the Australian dollar and New Zealand dollar failing to catch a bid on this 'positive' trade news. Part of the reason may be because investors do not see a Nafta 2.0 deal as any substantial softening in the US administration's protectionist trade stance – at least not in a way that would boost the odds of a US-China trade agreement in the near-term. But we also got some disappointing China manufacturing PMI data this morning – with the Caixin reading falling to the precariously neutral 50.0 level – which may have sapped some of the near-term market optimism (especially for satellite Asian FX). With Chinese markets on holiday – a stable USD/CNY may mildly help here.

EUR: Hit by double bogey of Italy, soft CPI but not stuck in the rough

As we note in our G10 FX week ahead, the euro got hit by a double sucker punch late last week in the form of a higher Italian fiscal deficit and disappointing core eurozone inflation. However, our rates strategists expect the 10-year BTP-Bund spread to stabilise in the 250-300 basis point area – and do not see a repeat of the BTP tantrum seen earlier this summer. As such, we think the latest Italian budget woes are set to have limited implications for the euro. Instead, we think EUR/USD price action will be driven by US data. Here, our economists note downside risk stemming from the potential for distortions related to hurricane Florence – and these likely softer figures may put a soft floor under EUR/USD around 1.1550.

GBP: Retain a buy-on-dips strategy as Tory Conference creates opportunity

It's not been the easiest of starts for Theresa May at the 2018 Tory Party conference – with the Prime Minister under leadership pressure from both Brexiteers and now Remainers (with Conservative MP Dominic Grieve stating that a 'significant' number of Tory MPs would back a second Brexit referendum). In theory, these perilous headlines should keep GBP under wraps – though there is a sense that speculative investors are bored of chasing a negative Brexit headline, especially if it doesn't materially alter the odds of a no deal Brexit. We would see any dips in GBP/USD in and around the Tory Conference as an opportunity to buy the pound – with a deal on the Irish border backstop to see a sharp re-pricing to 1.36-1.38.

CAD: A confirmed Nafta deal should see USD/CAD move down to 1.27-1.28

The loonie has rallied by more than +0.5% following news of a new Nafta trade deal being agreed. This comes after USD/CAD drifted towards 1.29 after Friday's beat in July GDP (+0.2% MoM vs. +0.1% expected) all but confirmed an October Bank of Canada rate hike. Indeed, markets are pricing in a 91% probability of this occurring later this month (24 October) – with the tailwind of positive Nafta news helping the case for further BoC tightening. We believe a confirmed Nafta deal in the next few days should see USD/CAD trading down to 1.27-1.28; were it not for a more cautious global risk backdrop, we may have even seen a run down to 1.25-1.26 in October. Canadian jobs report (Friday) may provide another boost for the loonie.

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