The euro: Hit by the Italian job

Our Monday FX rundown where we're looking for the dollar to rise but political concerns are having an impact elsewhere

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USD: Superficial US-China trade 'agreement' merely fuelling dollar strength

After weeks of trade negotiations, US and China issued a joint statement over the weekend noting that the latter would 'significantly increase purchases of US goods and services'. While it would be a stretch to call this a 'trade agreement' – given the lack of specific targets and ways to monitor progress – the decision by the US administration to put Chinese tariffs 'on hold' may help to ease global trade tensions. For our full week-ahead outlook see Trump's infinity trade war.

EUR: Pushback by President Mattarella would help ease Italian political risks

Italian politics remains front and centre for the EUR this week with the coalition government in making set to meet President Mattarella today. The latest area of concern is the idea of "mini-BoTs" – small euro-denominated, non-interest-bearing Treasury bills that could be partly used to finance looser fiscal policy. Indeed, what is seen as a de facto parallel currency would be a major negative development for the EUR should any new Italian government seek to pursue it.

We would expect to see some pushback from the President against the current debt-financed spending and anti-immigration policy agenda – which in principle could help to ease any lingering Eurozone break-up concerns. But with political risks bubbling again, we now see a higher bar for EZ data to positively drive the EUR in the short-term. While we are looking for a broadly unchanged set of May PMI releases (Wed) – which in the absence of political noise would be sufficient to lift ECB policy normalisation sentiment within markets – the EUR will take its cue from the 10-year BTP-Bund spread (which has widened by 35bp over the past week). A further widening in spreads would place downward pressure on EUR/$.

GBP: Royal wedding euphoria fails to spillover into a politically nervous pound

It's a big week for GBP – with macro data, Bank of England policy sentiment and UK politics all potential driving forces for the currency in the near-term. Though we would still argue that markets have lost faith and conviction over BoE policy tightening, we now place a strong emphasis on UK data to guide market policy expectations. Indeed, it's pretty clear what we'd need to see to support our call for an August BoE rate hike:

(1) resilient underlying inflationary pressures;

(2) a rebound in economic activity after the 1Q soft patch and

(3) no meltdown in Brexit talks or uptick in UK political uncertainty.

It's worth addressing the politics head-on – as this is fast-becoming the factor that is keeping us most awake at night. Over the weekend, we have seen two negative developments emerging –

(i) reports that Tory MPs are bracing themselves for a snap general election this Autumn and

(ii) an imminent fresh bid for Scottish independence from the SNP party this week.

While both remain just noise at this stage, these fresh political hits could keep sentiment for GBP dented in the near-term. The only offsetting factor could be UK data – where the perfect week for GBP bulls would be signs of sustained underlying inflationary pressures (core CPI at 2.2% YoY), a bounce back in ex-auto consumer spending (ING: +0.2% MoM; consensus: +0.5%) and a slight upward revision to 1Q UK GDP (prior unexpected to change). We also have BoE officials – including Governor Carney – testifying to UK lawmakers (Tue), but we don't expect any explicit policy signals – with policymakers happy to let the data do the 'talking'. Buckle up, it's going to be a bumpy ride for GBP this week.