

US-EU trade war remains key risk to euro

Trump's comments regarding EU car tariffs are a reminder that trade is still the biggest risk to the euro



USD: More of the same on the trade policy

Hopes for a rather smooth resolution of the US-EU trade dispute were dashed by President Trump's comments overnight. He described the EU's Trade Commissioner's idea to cut EU car tariffs to zero (conditional on the US doing the same) as "not good enough" and again reiterated the weakness of the euro (which gives the EU a competitive advantage). While the latter may put a soft floor under EUR/USD (as was the case during previous Trump comments on the euro), the potential escalation of the US-EU trade war remains a key risk to the euro as the initial reaction would be EUR negative (given the openness of the EU economy vs US as well as the pro-cyclicality of the euro). All this suggests that the current challenging environment for emerging market FX should remain unchanged.

EUR: Fitch rating review of Italy debt in focus

The core and headline eurozone CPI readings (expected at 1.1% and 2.0%, respectively) should have limited impact on the euro. The key focus today turns to the Fitch rating review of Italy's sovereign debt given recent Italian woes and the BTP-bund spread widening (currently not far from the May highs). We don't look for a downgrade (partly because the new Italian budget has not been presented yet) but a change in outlook (to negative) cannot be ruled out.

CEE FX: HUF to remain the underperformer

Central and eastern European currencies are feeling the spillover from the generally negative sentiment towards emerging market FX. Within the region, we continue to look for the Hungarian forint to underperform given that: (1) the dovish central bank remains extremely behind the curve vs its regional peers; (2) lowest funding costs in the region; and (3) EUR/HUF being not far away from the 330 pain threshold above which the inflation outlook for 2019 becomes an issue. While the Czech koruna is modestly weakening, the central bank rates outlook (two more hikes this year are very likely) means that this weakness should remain in check. In Poland, today's CPI (unchanged at 2%YoY) should have a limited impact on the zloty.