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Article

US-Mexico Nafta deal no panacea

Despite some progress with Mexico, we're still concerned about Trump's overall protectionist stance and think emerging markets remain fragile

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USD: Positioning may limit much of a dollar rebound this week

The US dollar index (DXY) is just over 2% off the highs seen in mid-August. This largely looks a function of stretched long dollar positioning, some remedial measures overseas (e.g. China's managed stability of the renminbi) and some better activity data out of Europe – most recently an encouraging recovery in the German August IFO. We think the dollar could correct slightly lower ahead of next Monday's US Labor Day public holiday, but it's probably too early to sound the all clear on Trump's protectionist trends – despite some progress with Mexico. Indeed, we're concerned that the push to place 25% tariffs on $200 billion worth of Chinese imports will come to dominate markets in September and that, in general, the emerging markets FX complex remains fragile. For today, we should see US August consumer confidence print near cycle highs (Monday saw a new high for US equities). Overall, DXY could dip to 94.00/94.20 this week, but not a high conviction call.

EUR: Italy may limit the euro bounce

The German IFO witnessed an impressive recovery in August and feeds the narrative that the 1H18 collapse could well have been triggered by temporary factors. After being bruised by the ECB's forward guidance, however, we doubt the market will have much enthusiasm in trying to chase a higher EUR on the back of a normalisation in ECB policy. The euro also has to contend with deliberations on the Italian budget in September, which could prove negative for the euro. We'll also see Fitch give an update on Italian sovereign ratings this Friday, although it will be too early to expect major changes before a budget has been agreed. 1.1600-1.1750 looks the range trade over coming days.

GBP: Breakout from an 11-month range

EUR/GBP has seen a decisive upside break-out, which could extend into the 0.91/92 area over coming weeks – ahead of fraught Brexit negotiations.

CAD: Tactically position for short-term upside as BoC tightening odds too low

Narrowing our focus to the September Bank of Canada meeting (5 September), we think there are material upside risks to the Canadian dollar – with markets underestimating the odds of a 25 basis point rate hike at the meeting (currently 22% priced in). Second-quarter Canadian GDP data this week (Wednesday) may see these odds pick-up sharply; our economists are looking for a 3.0% quarter on quarter annualised print – a touch stronger than the BoC's own 2.8% estimate in the July Monetary Policy Report. While Canada has been ‘left out’ of the US-Mexico preliminary trade deal, we note that Nafta is not dead in the water, not least as it is US Congress that has the power to terminate Nafta (not the President). We think CAD has solid reasons to post a short-term move higher and prefer to position for tactical upside (targeting USD/CAD 1.27-1.28).

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