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FX TALKING

FX Talking: Survival of the fittest

Fiscal-powered US outperformance continues to dominate FX markets while Italian politics is weighing on the EUR. If a Brexit withdrawal deal finally gets agreed, GBP could perform a little better too. The recent stability in Turkey and Argentina is starting to help EM FX in general, though China remains a major vulnerability



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Executive summary

Despite a market already long US assets, it's difficult for investors to rotate away from the US (and the dollar) at a time when global trade volumes are slowing, and US rates have yet to peak. Positioning and November US mid-terms are the biggest threat to the dollar right now, but overall we see the dollar holding gains into year-end.

Italian politics is weighing on the EUR. There seems little incentive for the populists to give major concessions to Brussels right now. And while cheap and potentially receiving support from ECB policy into 2019, EUR/USD will do well to hold above the 1.15 area into year-end.

Elsewhere in Europe, GBP could perform a little better if a Brexit withdrawal deal finally gets agreed. And the seasonal decline in inter-bank rates in Sweden and the Czech Republic could mark out SEK and the CZK as underperformers into year-end.

Recent stability in Turkey and Argentina is starting to help EM FX in general, though China remains a major vulnerability. We fear a test and marginal break of 7.00 in USD/CNY will undermine the nascent EM recovery. Despite China slowdown fears, the likes of BRL and MXN may outperform over coming months as investors warm to new Presidents. The honeymoon period may only last a few months, but given general EM gloom, honeymoons will nonetheless be welcome.

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