EUR/USD - A More Uncertain Outlook

• Uncertainty hangs over both the US and eurozone
• Eurozone also faces renewed political turbulence
• And the ECB faces some tough choices

The confluence of growing uncertainties on numerous fronts holds out the tantalising possibility of more sustained periods of higher volatility in EUR/USD over the second half of the year.

Fresh uncertainty surrounding the US economic outlook this week triggered the USD’s downward jolt which saw one month implied vol in EUR/USD reach levels not seen since early March.

And as we have suggested, there are no particular parameters that inspire confidence in the USD’s likely role, and hence trajectory, early in the second half of the year.

But equally, on the basis of current economic and political developments, the outlook for the EUR is no less uncertain.

It remains to be seen whether the eurozone’s rebound from last year’s soft patch has stalled irretrievably, but there can be no doubting the skewed downside risks to even modest official growth forecasts.

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of more-of-the-same would be understandable, and certainly the initial signs are not encouraging

Accordingly, we learnt yesterday that “Several [ECB Council] members [have] raised the possibility of further rate cuts” whilst “other members raised the possibility of restarting the asset purchase programme or further extensions in the forward guidance”.

However, in view of the limited progress that the ECB’s existing and prior policy measures have had in cajoling inflation, doubts in the likely efficacy of more-of-the-same would be understandable, and certainly the initial signs are not encouraging.

As investors – informed of core inflation’s recoil to just 0.8% two days earlier - digested Mr Draghi’s missives, the ECB’s favoured price gauge – the five-year five-year swap rate – was hurtling towards an all-time low. Meanwhile, investors showed little sign of balking at the 23bp they must offer the German Finance Ministry to lend them 10 year funds.

There is, after all, little doubt that League chief Matteo Salvini is riding high on his party’s success in the European elections

This uncertainty posed by renewed deflation risk and the likely policy response constitutes the backdrop to Italy’s renewed budget dispute with the EU.

As things stand investors appear in no more of a hurry to take note of the developing political uncertainty than they were in 2018; but things are moving quickly and as we learnt last year, Italian politics could well come to supplant all other considerations for the EUR.

There is, after all, little doubt that League chief Matteo Salvini is riding high on his party’s success in the European elections

3. President Trump considering ‘national emergency’ to force through Mexico tariffs - The Hill

4. Senior EU sources open to backing a fresh Brexit delay - Times

5. UK Labour Party holds Peterborough in by-election with Brexit Party in close second place

On the Radar

June 7, 2019

• US May non-farm payrolls (1330 BST)
• US May unemployment rate (1330 BST)
• CA May unemployment rate (1330 BST)
elections; and whereas the League / 5 Star coalition settled for a 1.9% deficit in their dispute last year, all signs are that a newly empowered Mr Salvini has his sights somewhat higher in 2019.

Indeed, reports suggest that he and 5 Star chief Di Maio discussed breaching the 3% deficit criterion earlier this week and just one day after Salvini spoke about respecting deficit limits only when the Italian unemployment rate reaches 5% (it stands at 10.2%).

Whether this year’s budget discussions amount to more than horse-trading only time will tell, but when complemented with acute uncertainty surrounding the ECB’s next move, this alone could ensure a more volatile environment irrespective of the role the USD takes-on in the months ahead.

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