STERLING KNOCKING ON RECORD LOWS

MORNING REPORT: 13TH AUGUST 2019

GBP

Sterling rose slightly from the multi-decade lows seen against the dollar and euro yesterday, with reports of a rebellion brewing in Parliament against no-deal Brexit in October perhaps providing some impetus. Various papers including the Financial Times are reporting that September 9th is a likely date for a showdown in the commons, with the Government preparing for debate in the commons after rebel Parliamentarians are expected to attempt to seize control of the House of Commons agenda. Sterling faces a more immediate test this morning, with the release of labour market data at 09:30 BST. The labour market is widely viewed as something of a saving grace for the economy as a whole, with rising wages expected by the Bank of England to continue to support consumer spending.

EUR

EURUSD feigned a move lower mid-morning yesterday, but quickly recovered and later even managed to close slightly higher, eventually. The Italian Senate failed to agree on when to have a vote of no-confidence in the current Italian government, which pushed the discussions to today. If a vote of no confidence in the current government is held, it is likely to pass, which will result either in snap elections in October, or a caretaker government until elections are held in Spring. October elections would be controversial as elections would then fall bang in the middle of the months in which the Italian budget plans for the coming year(s) are written. The centre-left PD party of former Prime Minister Matteo Renzi has already offered to form such a caretaker government with current coalition member, Five Star Movement. The other coalition party, the League, however, wants to hold elections as soon as possible, likely on the back of the huge advance the party led by Matteo Salvini has made in the polls lately. If elections would pan out as current polling suggests, this would allow Salvini to form a coalition with parties that are ideologically closer to the League, like the right-wing Brothers of Italy or Silvio Berlusconi's Forza Italia. The most relevant consequences for the euro will be what the spending plans of any potential new government will be. These spending plans may actually be less straining on Italy's fiscal debt position as a purely right-wing coalition would no longer allocate funds to the citizen's income plan, a campaign pledge by the left-wing FSM coalition member. After an initial period of political uncertainty, snap election could in that case calm Italian bond markets and be a minor tailwind to the euro.

USD

Since the DXY dollar index peaked at 26-month highs at the start of the month, the index has retreated somewhat again and has now been trading within a tight range for a week now. Multiple theories are currently doing the rounds about how squeezes in dollar liquidity may bring extra strength to the greenback in the coming months. First, the raising of the debt ceiling last week means the US government will issue more debt, which will scoop up liquidity from dollar markets. Second, FX swap contracts see rising spreads between US dollars and the rest of G10 currencies. As the dollar is crucial in many financial market transactions this is a sign market participants are currently willing to pay a premium to secure access to dollar liquidity in months and years to come. It remains to be seen how the Federal Reserve will respond to these liquidity squeezes because it can be a justification for the Fed to indeed deliver the 100 basis points rate cut markets currently price in for the coming 12 months. If the Fed indeed responds by lowering the rates, which makes dollar liquidity cheaper again, the pressures on USD may, in the end, balance out. However, if the Fed does nothing to counter the building USD liquidity shortages, this represents another upside risk for the greenback. Today sees the Consumer Price Index at 13:30 BST, which would pose awkward hawkish questions to the Federal Open Market Committee if the core reading jumps above the 0.2% monthly growth trend for the second month in a row.

CAD

The loonie is once again under pressure this morning, with firmness in crude oil prices proving of little assistance to the Canadian dollar. Friday's decidedly mixed labour market data continues to hang over the loonie, but with no further data releases scheduled until Thursday's ADP estimate of non-farm Payrolls, data from the US, general risk sentiment and crude oil are likely to lead loonie trading.