Nordea

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FX weekly: No Di-Maio'nnaise for your EURs (yet)

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It is too early to expect any Di-Maio'nnaise for your EURs, but the main culprit is not Italy. The re-steepening of the USD curve and the shrinking excess USD liquidity are to blame for the strong USD. The USD will not peak before mid-November.

Table 1: Our current list of convictions

Date	Direction	Trade	Rationale	Low	High*
30-Sep	Short	AUD/NZD	China liquidity boost to AUD is fading again		
23-Sep	Long	NOK/SEK	Norges Bank will outhike the Riksbank (despite rathe paths telling otherwise)		
26-Aug	Short	AUD/USD	Chinese impulse is a drag on AUD still		
24-Jun	Short	NZD/JPY	Positive risks from BoJ/LDP leadership and a US curve flattening bet		
07-Jan	Short	AUD/CAD	Oil to outperform copper in late US cycle		

Low to high conviction of trade

First, ***before engaging in more esoteric stuff,*** we offer some FX quickies for those of a tactical persuasion.

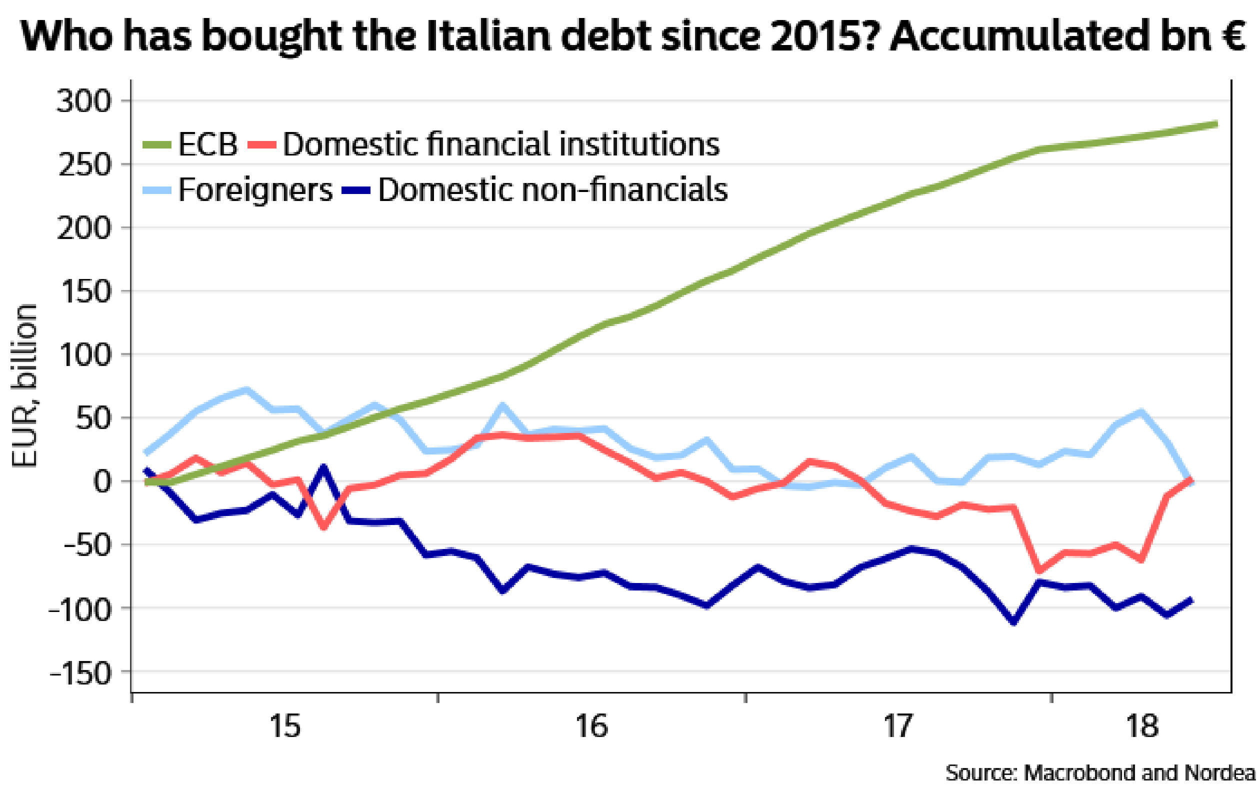
- **EUR/USD:** Slight downwards bias intact, as excess USD liquidity continues to shrink. 1.1570 the important topside resistance level. The USD will peak in mid-November.
- **EUR/NOK:** EUR/NOK is short-term slightly oversold after seven consecutive lower-lows until Tuesday last week. Consolidation towards 9.60 seems on the cards.
- **EUR/SEK:** SEK is seasonally weak in October, due to the re-pricing of the year-end, which usually leads Stibor rates lower. Judged from the recent pattern between EUR/USD and EUR/SEK, EUR/SEK is headed above 10.50 this week. **Above 10.50 there is thin air.** In NOK/SEK terms our implicit target is 1.1050.
- **EUR/GBP: Theresa May disappointed our long EUR/GBP at her speech on Wednesday.** We have low conviction, but our short EUR/GBP bias is re-installed, as Bank of England has a low tolerance for a weaker GBP (we close long EUR/GBP again). Arlene Fosters meeting with Michel Barnier this Tuesday is a key date for GBP bulls.

It has been another week of "Erdoganish" rhetoric from Italian leaders, albeit some concessions surrounding the 2020 and 2021 budgets have been made already. Sooner not later Luigi Di Maio and Matteo Salvini will have to dance after the markets tune. That is simply needed to avoid catastrophe.

Since the inauguration of the ECBs PSPP, ECB has been the only de facto funding source for Italy. Who will fund the increased 2019 budget deficit, if we anticipate that the ECBs stops net purchases 31st of December? The answer is most likely domestic banks. It is hard to see that fly without a further increase in the Ital-German spreads (Week ahead – A Bolognese full of "Erdoganish" deficit signals)

Concessions are needed from Italy also on the 2019 budget to avoid a big stand-off with the markets in to 2019, but we rest assured that we will get those concessions sooner not later. **It is though still too early to expect Di Maio'nnaise for your EURs** and Italy is not the only culprit in that regards.

Chart 1: ECB has bought all Italian debt since the PSPP programme was launched



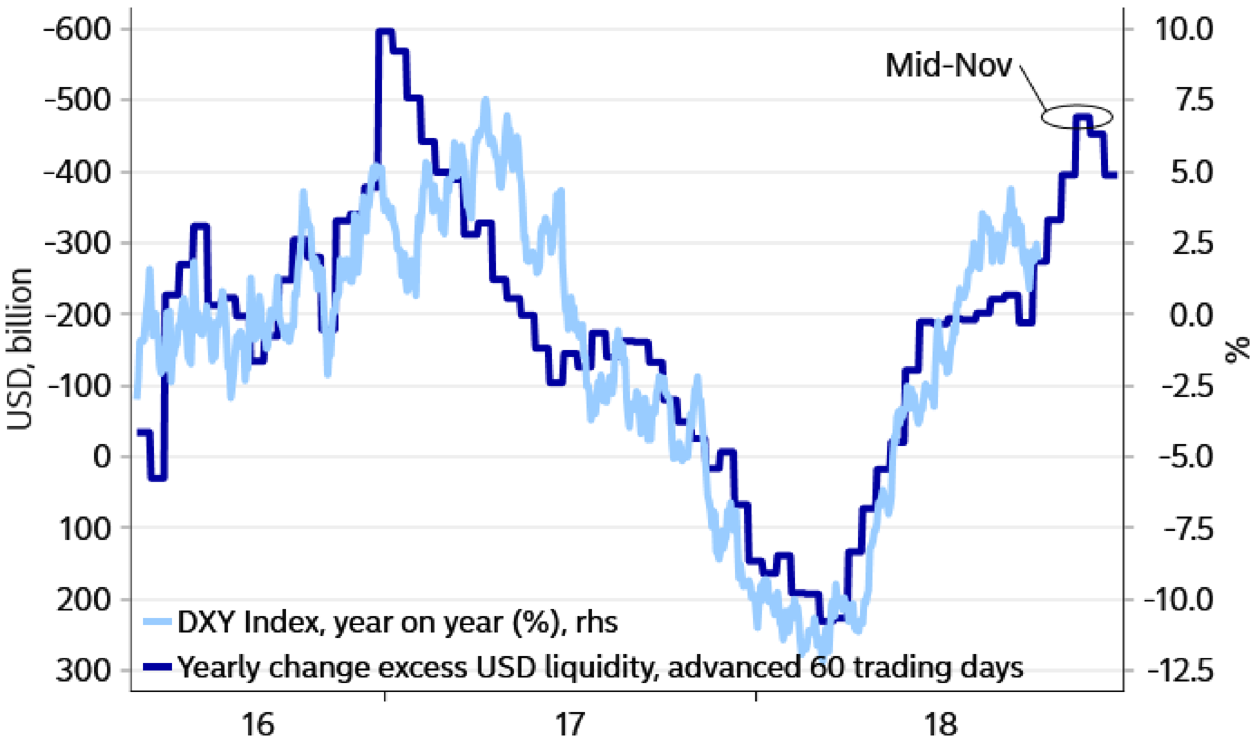
We have said it over and over, but we gladly reiterate the view again. **USD excess liquidity developments are an underappreciated driver of the trend in the broad USD (DXY) and in EUR/USD.** We estimate approximately 60 trading days of lead time in USD excess liquidity compared to the USD exchange rate.

On our lead/lag studies the USD will peak in Mid-November seen from an excess liquidity momentum perspective (though dependant on the liquidity shrinkage around year-turn. Maximum pace from QT is 50bn x 12) (see chart 2). A trend reversal that could be further fuelled, if we get another debt ceiling stand-off in early 2019 (a likely scenario, especially if the republicans lose the majority in the house). In such case the US Treasury will empty its cash balance at the Fed, **flushing the commercial banking system with up to 3-400 bn USDs (a USD negative scenario).**

Our buy-on-dips strategy in EUR/USD is hence off the table for now. We have a downside tilt in EUR/USD until mid-November, but we remain firm that the USD peak is getting closer (with mid-November being the most likely timing).

We though find e.g. an AUD/USD short a better way to play a positive USD-view (see more in the AUD paragraph a bit further down in the weekly)

Chart 2: The main culprit for the stronger USD is shrinking excess USD liquidity (note the reversed left axis)



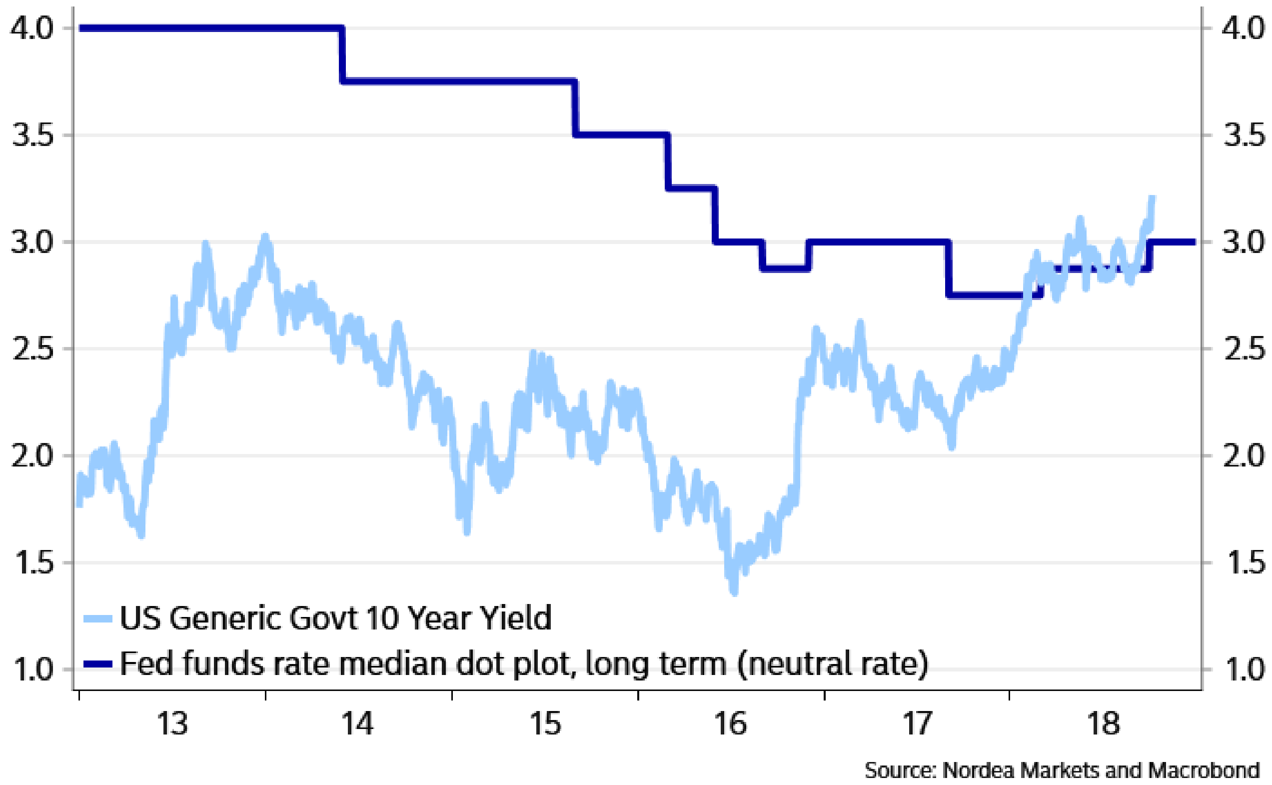
Source: Macrobond and Nordea

On top of the shrinking USD excess liquidity, **Chair Powell's "we may go above neutral" comments provided a green light for 10yr treasury yields to head above the long-term neutral rate assessment** from the dot plot (see chart 3).

3.12% is now materially broken on the topside in the 10yr treasury yield and above that level there is "thin air" technically. The recent re-steepening of the USD curve has allowed 10yr treasury bonds to regain some attractiveness (post rolling short-term FX hedges, if we look aside temporary year-turn effects) for international investors. **A steeper USD curve is a USD positive flow wise**, if it happens for the right reasons (i.e. not due to twin deficit scares).

A steeper USD curve is though likely only a temporary phenomenon (supporting our idea of a USD peak in November).

Chart 3: The 10yr treasury yield has broken above the long-term neutral rate assessment



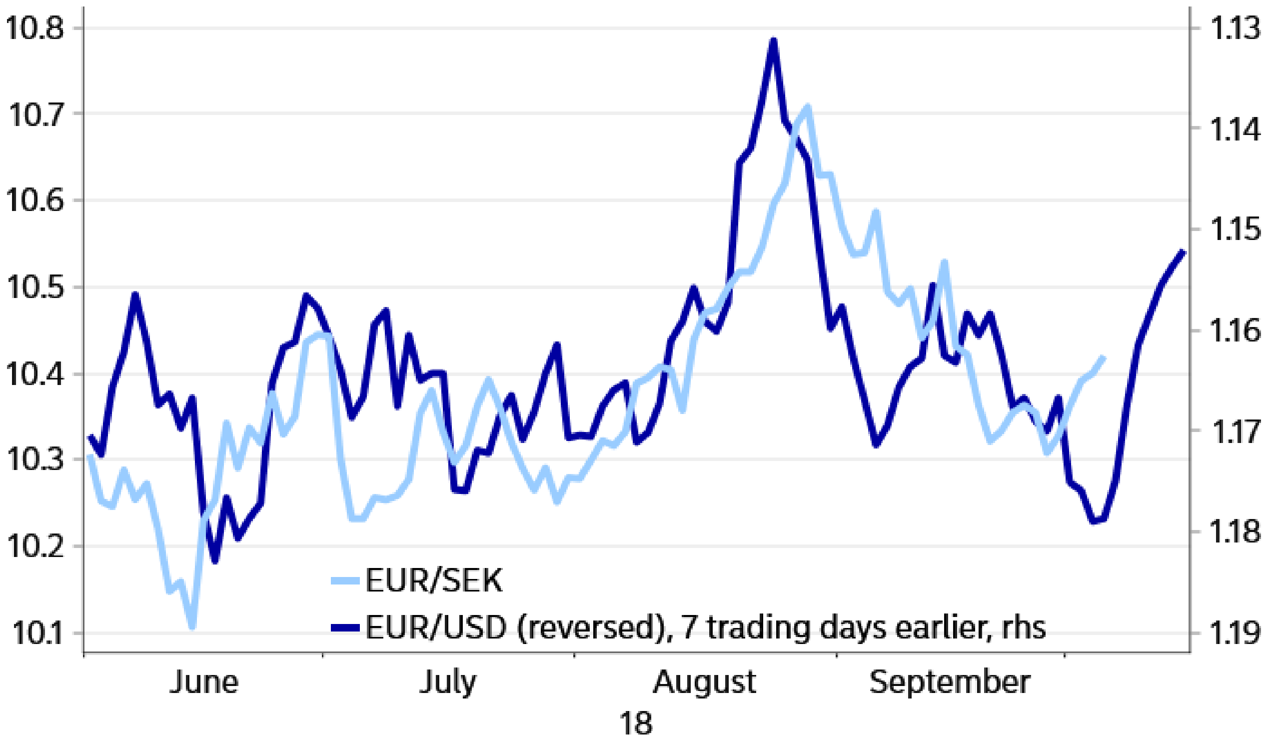
On a side note, our idea that EUR/USD always heads lower on *SOMA-days* (a day when Fed's bond portfolio shrinks), received another confidence boost on Monday, as EUR/USD headed lower during the afternoon-trading (again, again). **This is now 10 SOMA-days in a row with lower EUR/USD at 17:30 CET** (FX weekly: Along came year-end).

A hawkish Powell is not food for EUR/Scandi bears

A strong USD is not good news for those who hope to see EUR/SEK and EUR/NOK headed lower. We have recently written about how a strong USD tends to spill-over to higher EUR/SEK and EUR/NOK, as a strong USD (and the underlying strong US relative asset performance) tempts local Scandinavian investors to buy USD assets unhedged, leading USD/SEK and subsequently EUR/SEK higher (the same pattern is also partly seen in EUR/NOK).

Even though USD/SEK (and USD/NOK) looks toppish again, recent lead/lag patterns suggest that a lower EUR/USD spills-over to higher EUR/SEK 5-7 trading days later. **10.50 is set to be breached in EUR/SEK next week, if the pattern persists.** Above 10.50 there is thin air in EUR/SEK technically.

Chart 4: Where is EUR/SEK headed? Ask EUR/USD a week ago.



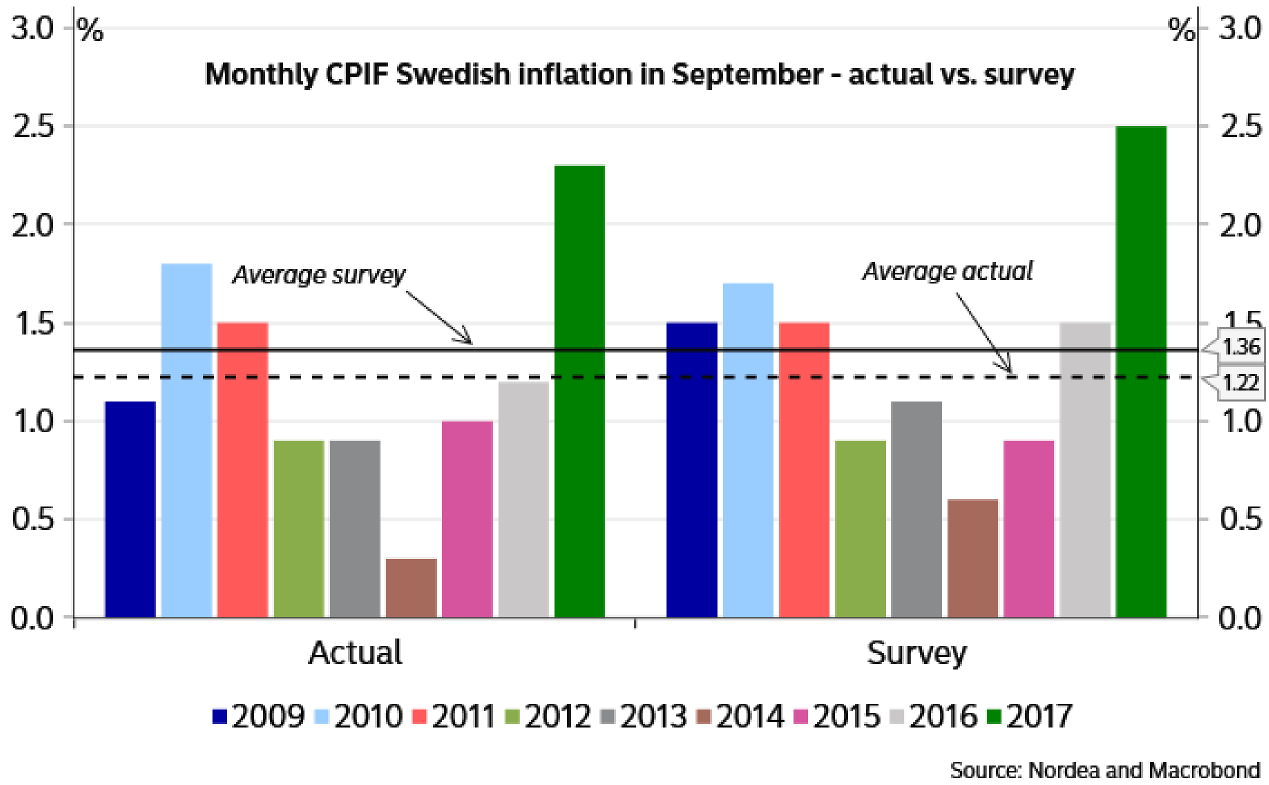
Source: Macrobond and Nordea

On top of the strong USD, another inflation print on the downside of the Riksbanks expectations looms in Sweden on Thursday. September is one of those months, when consensus almost always overestimate the actual outcome for Swedish inflation – on average by roughly 0.15 percentage points. Our Macro-team leans in the same direction (Swedish September CPIF preview: Risks on the downside)

This doesn't bode too well for SEK into next week - especially given that the all-important deputy governor of the Riksbank, Per Jansson, recently hinted that a pronounced rebound in core inflation (and service inflation in particular) is needed for the December (or Feb-19) hiking plans to come into fruition.

On top of the inflation forecast seasonality, **it is noteworthy that EUR/SEK has traded higher in 9 out of the last 10 Octobers.**

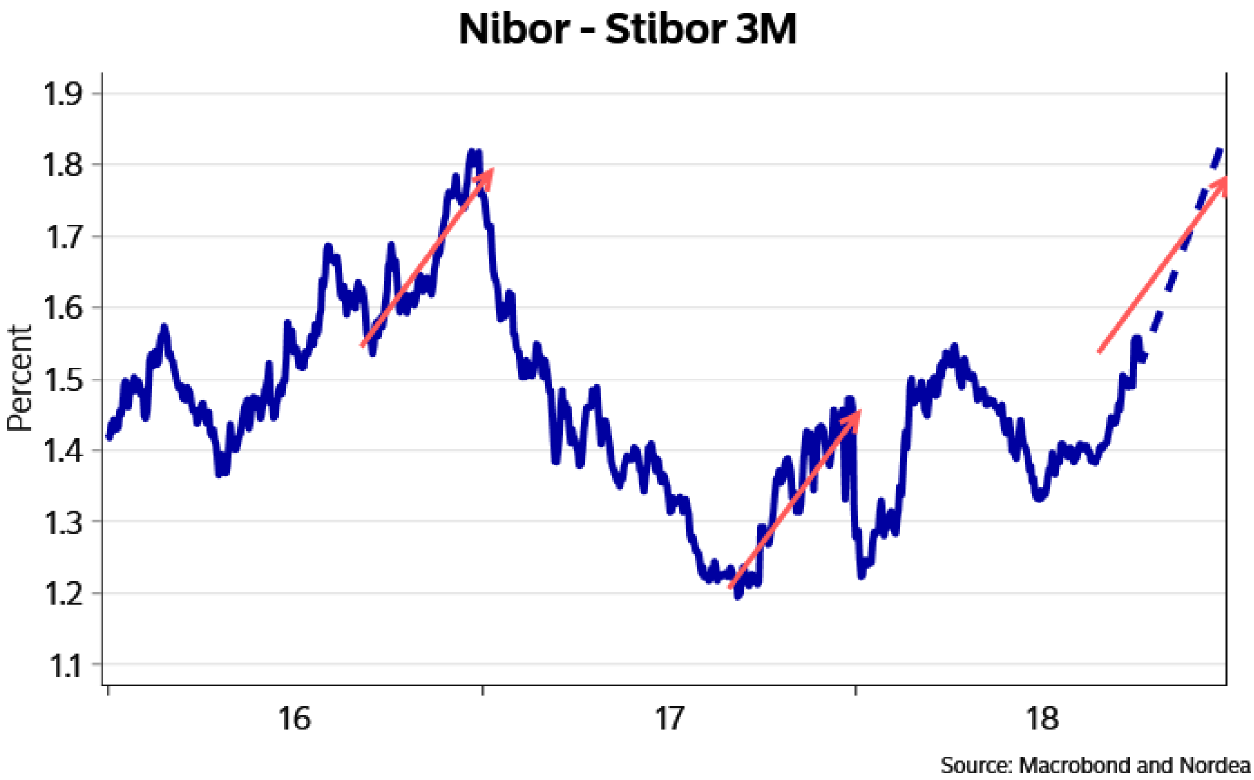
Chart 5: Consensus tend to overestimate September inflation in Sweden



In the relative Scandinavian ball-park we stay long NOK/SEK with a target of 1.1050. If the usual year-end repricing plays out (and why shouldn't it), Nibor-Stibor 3m spreads could widen another 25-30 basis-points (FX weekly: Along came year-end)

Long NOK/SEK is another position with an excellent October track-record (80% hit ratio roughly).

Chart 6: Nibor – Stibor year-end repricing to support a long NOK/SEK position

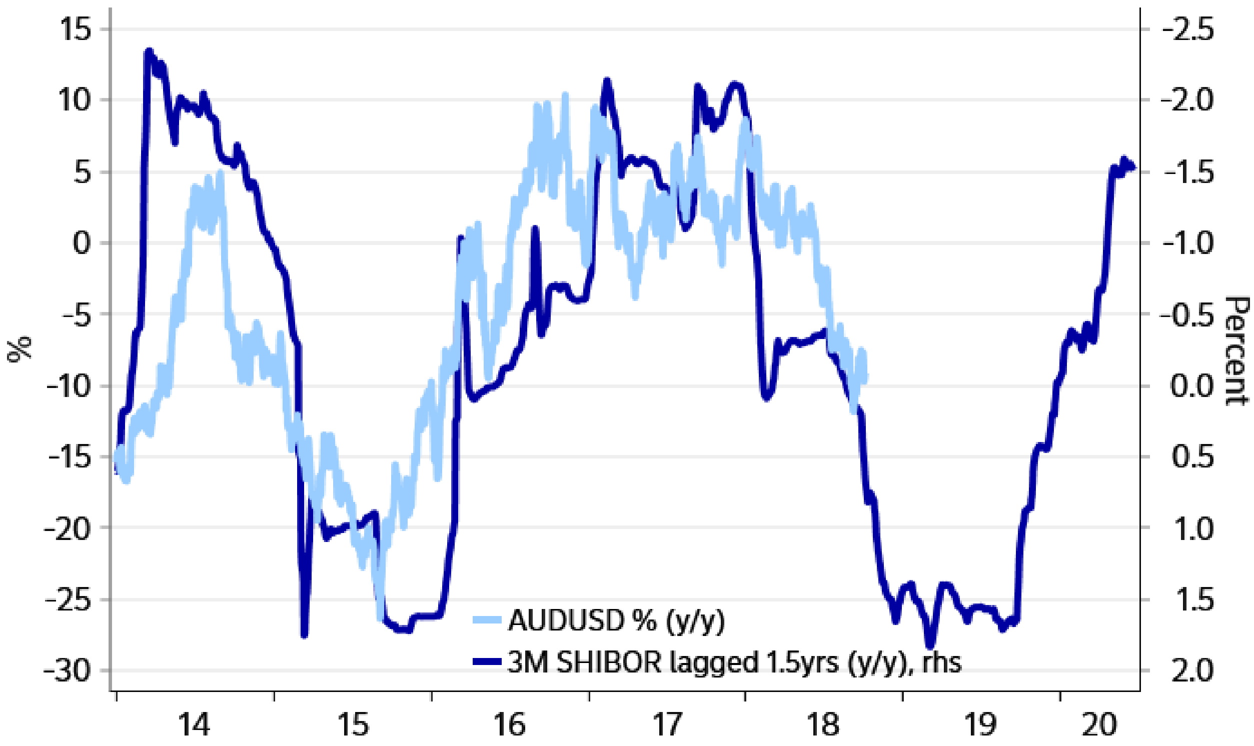


AUD: A terrible Q4 coming up?

Another month, another y-t-d low in AUD/USD, but it doesn't stop here. On our lead/lag studies between the Chinese cycle and AUD/USD performance, **we need to wait until 2019 before the recent Chinese liquidity injection and the subsequent lower Shibor-rates will be helpful for Australian momentum.**

If 2014-onwards correlations hold, AUD will face a terrible Q4 this year (see chart 7). We keep a short AUD bias against both CAD, NZD and USD in to year-end.

Chart 7: Chinese liquidity injections (and lower rates) will not help Australian momentum until 2019 (note the reverted right-hand axis)



Source: Nordea Markets and Macrobond

CAD: Waiting for a post-NAFTA ketchup effect

CAD is currently the king of the commodity FX space (look at the move lower in AUD/CAD last week) and we reckon that it will continue another while. Substantial amounts of Canadian investment activity have been pushed back until the NAFTA uncertainty lifted (see chart 8). We expect a ketchup effect in Canadian activity in Q4, which should be supportive of a hawkish BoC.

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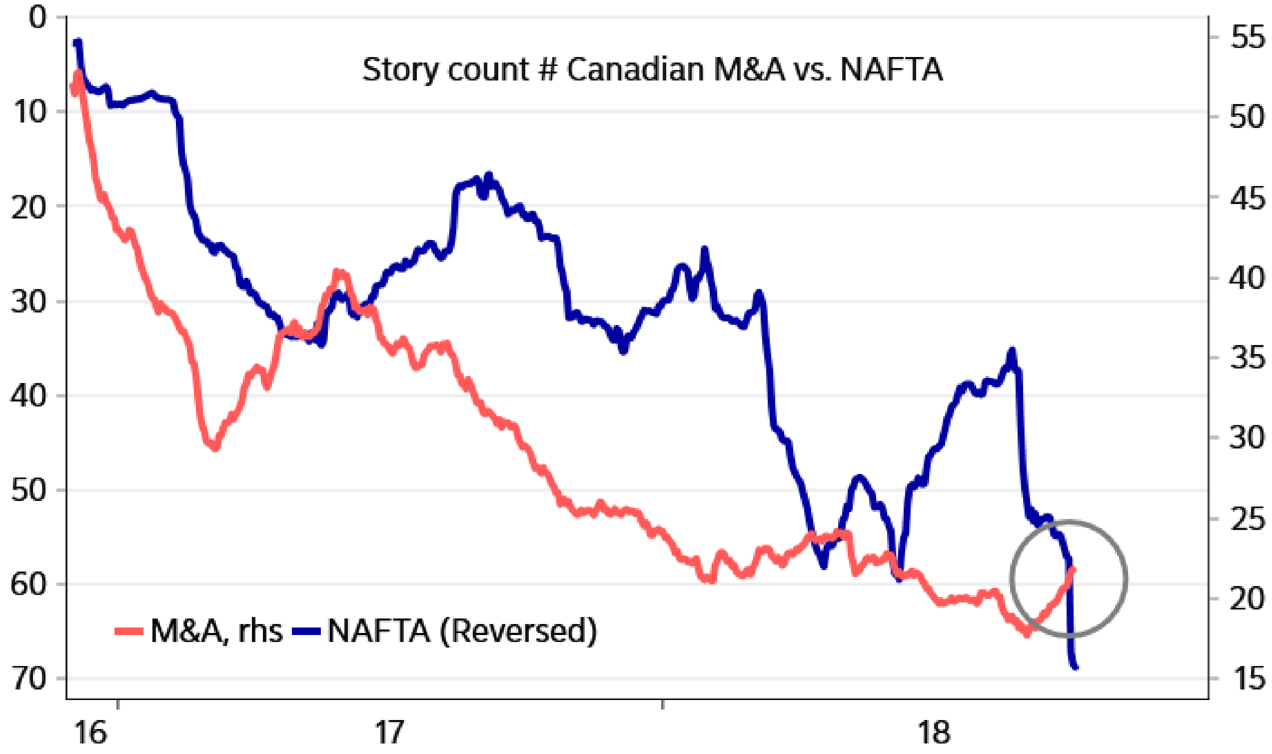
Chart 8: As NAFTA uncertainty picked-up, Canadian M&A activity plummeted. A reversal of trends has though started (note the reversed left-hand axis)



Source: Macrobond and Nordea

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·FX weekly: Along came year-end (30 Sep)

·FX weekly: Twin deficit scare #2 (23 Sep)

·FX weekly: The Pope of Nope has spoken! (16 Sep)

·FX weekly: Who wants to impeach a +60 ISM president? (09 Sep)

·FX weekly: It is time to go long Scandis again (02 Sep)

·FX weekly: The Conte-Trump alliance (26 Aug)

·FX weekly: Fat-burning shorts (19 Aug)

·FX weekly: Time to call in Steven Seagal(12 Aug)

·FX weekly: Is the cyclical momentum over-priced? (05 Aug)

·FX weekly: How to trade a cease-fire? (29 Jul)

·FX weekly: What's that curve? (22 Jul)

·FX weekly: The China Factor (15 Jul)

·FX weekly: Take a short trade war breather (08 Jul)

·FX weekly: Trump will never #238 (01 Jul)

·FX weekly: The USD is the best carry currency in the world (24 Jun)

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·FX weekly: A numbers game (17 Dec)

·FX weekly: The year-end liquidty shrink (10 Dec)

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·FX weekly: Is high-yield a canary in the global coal mine? (12 Nov)

·FX weekly: Is this the end of the inflation convergence trade in EUR/USD? (5 Nov)

·FX weekly: Was that it for the EUR bulls? (29 Oct)

·FX weekly: Hawks in opposition, doves in charge (22 Oct)

· FX weekly:Continued convergence or re-divergence?(15 Oct)

·FX weekly: Thingsdon't matter until they do(08 Oct)

·FX weekly:"October seasonality is strong" (01 Oct)

·FX weekly:"Is 1.20 the new 1.15?"(24 Sep)

· FX weekly:Honey, I shrunk the balance sheet(17 Sep)

· FX weekly: "USD liquidity will turn scarcer, but when?" (10 Sep)

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· FX weekly:"USD in the (Jackson) hole" (27 Aug)

· FX weekly:"Q4 is the USD quarter"(20 Aug)

· FX weekly:"In the year 2525"(13 Aug)

· FX weekly:"EUR/USD ceiling or debt ceiling?"(6 Aug)

· FX weekly:"Elevator up, stairs down "(30 Jul)

· FX weekly:Trump "spices" up EUR/USD(23 Jul)

· FX weekly:Flip-flop?(16 Jul)

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· FX weekly:Another lowflation week?(25 Jun)

· FX weekly:No Fed put?(18 Jun)

· FX weekly:A bouncy dollar?(11 Jun)

· FX weekly:Heating up(4 Jun)

· FX weekly:Summertime sadness(28 May)

· FX weekly:Special counsel lessens Trumpbulence, while OPEC looms(21 May)

· FX weekly:Are China worries old hat?(14 May)

· FX weekly:Inflation week...(7 May)

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