

The shift to the left in European politics, the EUR and the NOK

Asia overnight

While Asian bourses were mostly softer at the time of writing, S&P 500 futures were modestly in the green. Asian bourses were weighed by news reports that China's officials are potentially looking to break up Ant Group Co.'s Alipay. Democrats on the House Ways and Means Committee are looking at, among other things, proposing a rise in the US corporate tax rate from currently 21.0% to 26.5% to help pay for President Joe Biden's USD3.5trn spending plan; 26.5% is less than the 28.0% being sought by Biden. Other measures include higher taxes on high income earners as well as cryptocurrencies. US Democratic Senator Joe Manchin continues to register his disapproval for the USD3.5trn bill and is proposing a USD1.5trn package and smaller tax rises. G10 FX was trading in tight ranges in the Asian session with the CAD, USD and JPY being modest outperformers and the EUR and CHF slight underperformers. The NZD was weighed down a little by the extension of the lockdown in NZ's largest city, Auckland.

AUD: eyeing iron ore?

According to our FAST FX model, the strongest drivers of AUD/USD currently are commodity prices (especially iron ore) as well as the Australian-US box yield spread. While the influence of commodity prices has been waning, the importance of the box yield spread has been rising. Indeed, both fundamentals are about equally important drivers of the exchange rate at the moment. The box spread is being driven by expectations around the FOMC and RBA's tapering, and US CPI and Australia labour market data will be big factors for the AUD/USD this week. The RBA clearly showed its intention last week by beginning its tapering despite lockdowns. There has been some good news on the lockdown front with Australia's largest state, NSW, outlining an exit strategy from lockdowns that could begin as early as late October. Iron ore prices have not been favourable for the AUD, however. China usually curbs steel production during the winter months in order to reduce pollution, which is already being added to by coal-fired power stations producing electricity for heating. The hosting of the Winter Olympics in Beijing in February has iron ore traders expecting this curbing of steel production to last longer than usual. China's cyclical data pack for August this week will be in focus for the AUD, and our China economist looks for downside surprises relative to the consensus forecasts for retail sales and industrial production. Measures designed to cool the residential property market and curb pollution produced by steel mills as well as authorities' regulatory measures are expected by our economist to weigh on this week's data along with some sporadic Covid lockdowns.

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The German general election on 26 September remains the main political event this month. Ahead of the vote, the SPD has been gaining in the polls, largely at the expense of its main rival, the CDU. Given that the third most popular party – the Greens – shares the SPD's stance on fiscal activism and European fiscal solidarity, the recent polls could suggest that the German voters favour a very gradual withdrawal of the fiscal stimulus introduced during the pandemic and even support further steps towards European fiscal federalism. The EUR has not reacted to these developments, mainly due to the persistent uncertainty about the composition of the ruling coalition after the vote. That said, should the SPD and/or the Greens dominate any future German government, this would be seen as a EUR-positive development by the markets. On the day, focus will also be on the outcome of the Norwegian general election. Ahead of the vote, the centre-left Labour party seems on course to replace the incumbent Conservatives at the helm of the government. A Labour victory could see fiscal activism returning (eg,



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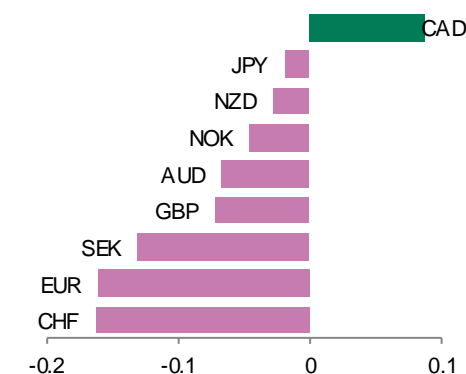
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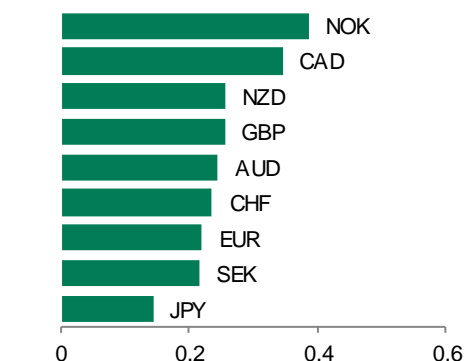
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Overnight returns (% , vs USD)



Source: Bloomberg, Crédit Agricole CIB

1M implied volatility daily change (net, vs USD)



Source: Bloomberg, Crédit Agricole CIB

tax cuts) and thus boost the economic outlook while increasing the official NOK-purchases in the FX market. There have been concerns about the country's oil sector under a potential Labour coalition with the Greens or the Socialists. That said, any environmental policies will likely be longer-term in nature so that the NOK could still benefit from any growth-positive fiscal policies in the near-term.

The three pillars of our constructive USD view, revisited

We revisit the three positive USD-developments that we expect in October/November. While we recognise that growing uncertainty with respect to the US fiscal stimulus and the debt ceiling resolution in particular may limit any USD upside in the very near term, we still see the two as important pillars of our constructive USD view in the next two to three months:

1. Fed QE taper, which we still expect in November and which could reduce the USD excess liquidity in FX markets, supporting the currency. We think that the Fed is on course to deliver cautious taper as US inflation accelerates and the labour market data shows further improvement from here.
2. The US fiscal stimulus package, which we tentatively expect in October/November and which can boost the UST issuance and thus reduce the excess USD liquidity, boosting the currency. That said, uncertainty has been growing over the Democrats' ability to find consensus on the stimulus amount ahead of the vote in the House scheduled for late September. Indeed, Democrat Senator Joe Manchin continues to push back the timeline for passing the legislation and has suggested a watering down of the tax measures in order to increase the chances of the package passing through Congress. The USD price action could be increasingly shaped by the prospect of fiscal stimulus.
3. The US debt ceiling resolution, which we tentatively expect in October/November. This will allow the US Treasury to issue debt that, in turn, will soak up excess USD liquidity and boost the currency. Uncertainty about the issue has been growing of late, with the GOP refusing calls by the Democrats for a bipartisan solution. The USD price action could be increasingly shaped by the prospect of a compromise between the two or, alternatively, a decision by the Democrats to extend the debt ceiling on their own.

Open trade recommendations

	Date	Opening Time	Direction	Entry	Target	Stop	Last	P&L*
XAU/USD	24-Nov-20	07:11 GMT	Long	1,828	2,140	1,628	1,791.04	-0.40%
GBP/USD	21-Apr-21	13:46 BST	Short	1.3917	1.3250	1.4250	1.3829	0.52%
USD/JPY	16-Jun-21	19:14 BST	Long	110.2600	115.0000	107.8500	109.9600	-0.31%
EUR/JPY	02-Sep-21	10:06 BST	Long	130.3200	134.5000	127.5000	129.7000	-0.43%