



Julius Bär

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CURRENCIES & MORE OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Kiwi: Due to uncertainties about the new government, the Kiwi will likely trade lower in the days ahead
Euro: Mario Draghi said the ECB still sees some imponderabilities to the medium-term inflation outlook
Pound: Round four of the Brexit talks started yesterday, eventually tackling the divorce bill this week

Kiwi: Clear as mud

In the aftermath of last Saturday's election, we follow up on the most likely time line and consensus building in FX markets on how a potential coalition will likely evolve. Uncertainty will remain elevated in the coming weeks, with both the National Party and Labour Party going into negotiations with other parties to try to form a coalition government.

Who is giving way to New Zealand First?



Source: Chris Slane

The preliminary election results showed that the National Party lost 2 seats from the 2014 election, down to 58 from 60, while Labour gained 13, up to 45 from 32. Yet, this might change as around 380'000 special votes – or 15 percent of the total votes – still need to be counted. The processing of special votes – typically where voters are unable to cast a vote in their own electorate or live abroad

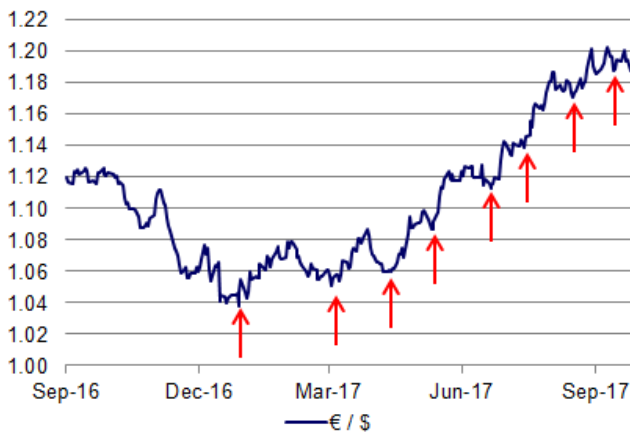
– only takes place after election day. The deadline for special votes to be in the hands of Returning Officers is 10 days after election day. Typically, the center-left gains from special votes. We have to wait until the first week of October to get the final election result. As outlined in yesterday's review of the election, New Zealand First leader Winston Peters is widely seen as the "kingmaker". His party won the most seats of the potential "junior partners" – 9 – while Green won 7 and ACT, the Association of Consumers and Taxpayers, garnered the final one in the 120-seat Parliament. The National Party once signed a "memorandum of understanding" with the Green Party after the 2008 election, but this lapsed in 2011 and was not renewed while it had a "confidence and supply agreement" with ACT. Ideologically, the Green Party tends more toward Labour. ACT has been part of the coalition in the former government. Consequently, it is all about New Zealand First, whose policies have a populist bias, with a strong emphasis on restricting immigration, targeting foreign buyers of property, along with putting "New Zealanders first" in matters of employment, healthcare and education. Unlike other countries, this manifesto fits more to Jacinda Ardern's Labour Party than to the National Party. Ardern is also advocating a lower rate of immigration to New Zealand. In a scenario of Labour together with New Zealand First and Green parties forming a coalition, immigration policies may be tightened quickly. This would be negative for growth. Another source of market concern could relate to potential changes to the RBNZ Act under this potential government. They intend to broaden the central bank's objectives beyond price stability. Such changes may raise uncertainty about the future path of the RBNZ's Official Cash Rate.

Conclusion: We think the Kiwi will be weighed down by uncertainty in coming weeks as FX markets await the results of coalition talks.

Euro: Patient and persistent

ECB President Mario Draghi spoke at the quarterly hearing at the European Parliament Committee in Brussels. On one side he said that “we are becoming more confident that inflation will eventually head to levels in line with our inflation aim” but on the other side he stressed that “we also know that a very substantial degree of monetary accommodation is still needed for the upward inflation path to materialize”. He concluded that “we therefore need to be patient and persistent”. The Euro continued to trade on the soft side but remains still in its range that began at the beginning of this month. As long as there is no convincing sign of exhaustion in €/ \$ – meaning lower lows – we do not see any reversal of the 9-month long uptrend.

€/ \$ is still making higher lows



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: As long as €/ \$ is not making lower lows, a sustainable correction is rather unlikely.

QUICK NEWS HEADLINES (time in CEST)

The following two headlines might have an impact on currency markets today:

- Sweden: August PPI will be released at 09:30.
- Mexico: The unemployment rate for August is expected at 3.4% (15:00).

Pound: Round four

The fourth round of Brexit began only yesterday, as they have been postponed due to Prime Minister Theresa May’s speech last Friday. As we know, May’s keynote speech in Florence offered nothing new, therefore Michel Barnier, the E.U.’s Chief Negotiator, will test how much further the U.K. is willing to bend. As May avoided naming any sum for the Brexit bill, maybe this week Brexit Secretary David Davis will bring up an amount. Ahead of the meeting,

Davis said the U.K. would pick through every line of the E.U.’s calculation of its divorce bill. He already dismissed sums floated by E.U. officials. This suggests that any initial deadline of getting E.U. leaders’ approval to move on to trade talks at their mid-October summit looks increasingly out of reach. Consequently, we expect the rate-hike-induced move up of Sterling to fade and a correction to set in soon due to unchanged realities in politics.

Cable in the past 12 months



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We expect the Pound to reverse its rally relatively soon.

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CONTACTS

FX Market Advisory Zurich
+41 (0) 58 888 8484

FX Market Advisory Geneva
+41 (0) 58 885 3551

FX Market PB Solutions Zurich
+41 (0) 58 888 8484

FX Market Advisory Hong Kong
+852 2979 2688

FX Market Advisory Singapore
+65 682 71 790

Author: Jürg Mettler
+41 (0) 58 888 8454

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