

As the political clouds lift, what will investors focus on?

Asia overnight

With the US and Japan on holiday today, G10 FX was relatively quiet in the Asian session. The NZD was the biggest mover and weakest performer. It was announced Saturday that the Labour and Green Parties had each picked up two additional seats in the final vote count for the general election. Both the incumbent National Party and main opposition Labour Party still require support from NZ First to form government. China's services PMI data were weak and weighed on the AUD. The USD trickled lower on the back of the confusing non-farm payrolls reading of Friday.

NZD: Government expected by Thursday

A Labour-Green Party coalition now has 54 seats in the 120-seat parliament, which still short of a majority. The incumbent National Party has 56 seats. So both the Nationals and Labour need support from NZ First, which has 9 seats, to form government.

Coalition negotiations have been going for two days now with both the Nationals and Labour indicating good progress and NZ First's leader, Winston Peters, saying that there was no reason that a government should not be formed by his self-imposed deadline of Thursday, 12 October. Headlines about the negotiations should keep the NZD volatile this week.

A National-NZ first coalition would have a 65-seat majority in the 120-seat parliament. Such a coalition, while not ideal, would likely lead to a bit of a relief rally in the NZD unless NZ First wins big concessions on migration, foreign investment and the RBNZ Act.

A Labour-Green-NZ First coalition would have a 63-seat majority, but would be volatile. Indeed, Labour would have to manage not only its relationships with the Green Party and NZ First, but also the volatile relationship between NZ First and the Green Party, which has been acrimonious in the past. So the Labour's path to government remains more difficult than National's.

We continue to think that such a three-way coalition government would weaken the NZD as it would not only reduce migration, foreign investment and the RBNZ's commitment (albeit modestly) to inflation targeting. It would also be unstable and very likely not what the electorate wants.

A third potential outcome is NZ First sitting on the cross bench and supporting the Nationals and supply and confidence motions, while considering each piece of legislation independently. This outcome would be the second worst outcome for the NZD given that it would allow significant political uncertainty to persist.

AUD: Australian High Court Rulings this week

Australia has its own political drama with the Australian High Court ruling this week (10-12 October) on the eligibility of several MPs to sit in parliament given their 'dual citizenship' status. The key ruling is the eligibility of Deputy PM Barnaby Joyce. If Joyce is disqualified from parliament, it would trigger a by-election that would place in jeopardy the government's one-seat majority in the House of Representatives. It would increase the political uncertainty in the AUD in the near term, but given Joyce would likely win the by-election, it would unlikely impact the medium-term trend in the AUD.

European morning: politics still the dominant driver

Both EUR and GBP have suffered from resurgent political risks of late. Looking ahead, there are still no signs that the confrontation between the Spanish government and the Catalan officials will be easing anytime soon. Indeed, the



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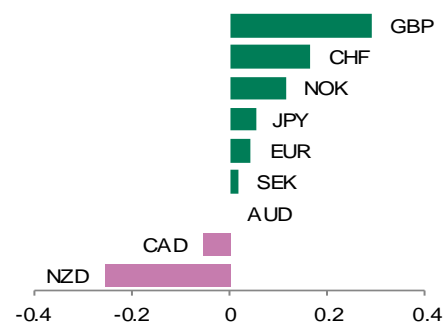
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Overnight returns (% vs USD)



Source: Bloomberg, Crédit Agricole CIB

G10 FX Forecasts

	Today	Dec-17	Mar-18	Jun-18
EUR/USD	1.17	1.22	1.22	1.23
USD/JPY	113	110	108	110
EUR/JPY	132	134	132	135
GBP/USD	1.31	1.36	1.36	1.37
EUR/GBP	0.90	0.90	0.90	0.90
USD/CHF	0.98	0.95	0.95	0.95
USD/CAD	1.25	1.24	1.22	1.21
AUD/USD	0.78	0.78	0.76	0.80
NZD/USD	0.71	0.69	0.68	0.70
EUR/NOK	9.38	9.15	9.00	8.80
EUR/SEK	9.53	9.40	9.30	9.20
EUR/CHF	1.15	1.16	1.16	1.17

Source: Bloomberg, Crédit Agricole CIB

latter could announce independence as soon as Tuesday whereas the former has already threatened to suspend the Catalan autonomy in response. On the day, investor confidence data out of the Eurozone and/or German trade data may still leave politics as the main EUR driver, suggesting that investors will remain cautious on the currency for the time being.

Further out, however, growing popular support for a renewed dialogue between the two sides could ultimately lead to a constructive resolution of the conflict in our view. We subsequently do not expect that the latest slide on EUR against most of G10 currencies should not be sustained. Should the political cloud hanging over EUR start lifting in coming days, this will allow investors to focus on the continuing improvement of the Eurozone fundamentals. The data calendar later in the week contains the final September HICP print as well as appearances by various ECB officials including the President. These could fuel market bets that the Governing Council may cut its monthly purchases more aggressively than the market is expecting at its October meeting. In turn, this could lead to further upside in EGB yields and help EUR regain some lost ground.

GBP was another G10 currency that struggled under the cloud of political uncertainty recently. Following the Conservative Party conference last week, however, PM may be now able to consolidate her power. This week we may learn more about any potential steps (eg a cabinet reshuffle) aimed at boosting Ms May's standing inside the government and the Tory party. It remains to be seen whether this can help reduce investors' uncertainty about the outcome of the ongoing Brexit negotiations. Elsewhere, the August IP and MP releases due later in the week may attract some attention especially if they highlight that the British economy regained some momentum in Q3. That said, the data is likely to be seen as somewhat dated especially given the disappointing September PMIs released recently. In all, we think that GBP should remain vulnerable against both USD and EUR for the time being.

Open Trade Recommendations

Underlying	Date	Opening Time	Direction	Notional	Entry	Target	Stop	Last	P&L Indiv.	P&L Portfolio
EUR/NOK	07-Aug-17	10:37:00	Short	3,000,000	9.3765	9.1000	9.5500	9.3789	0.18%	0.01%
EUR/CHF	09-Aug-17	11:49:00	Long	3,000,000	1.1320	1.1800	1.1345	1.1478	1.45%	0.04%
EUR/USD	28-Sep-17	11:35:00	Long	3,000,000	1.1770	1.2200	1.1520	1.1735	-0.34%	-0.01%
Open trades P&L									0.04%	

Underlying	Date	Option Type	Notional	Strike	Barrier	Spot Entry	Cost	P&L Indiv.	P&L Portfolio
EUR/JPY	17-Jul-17	3M Call spread	28,627,500	134/136	-	128.82	0.25%	-0.20%	-0.06%
AUD/NZD	12-Sep-17	1M one-touch	240,780	1.15	-	1.0985	10.00%	-10.00%	-0.02%
EUR/SEK	12-Sep-17	4M 1x1.5 Ratio put spr.	23,908,000	9.45/9.30	-	9.538	0.26%	0.02%	0.01%
Open trades P&L									-0.08%

Key Events

BST	Country/Zone	Indicator/Event	For	CA-CIB f/c	Cons.	Prev.	Comment
07:00	GE	Industrial Prod. YoY	Aug			4.00%	
07:30	FR	Bank of Fr. Bus. Sentiment	Sep			104.07	
08:00	DE	Trade Balance	Aug			7.37 B	
08:30	SW	Consumption	Aug			3.00%	
08:45	EZ	ECB's Mersch speaks in Milan					
09:30	EZ	Investor Confidence	Oct			28.22	
17:00	EZ	ECB's Lautenschlaeger speaks in Stuttgart					

Source: Bloomberg, Crédit Agricole CIB

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