Brazil: One last rate cut

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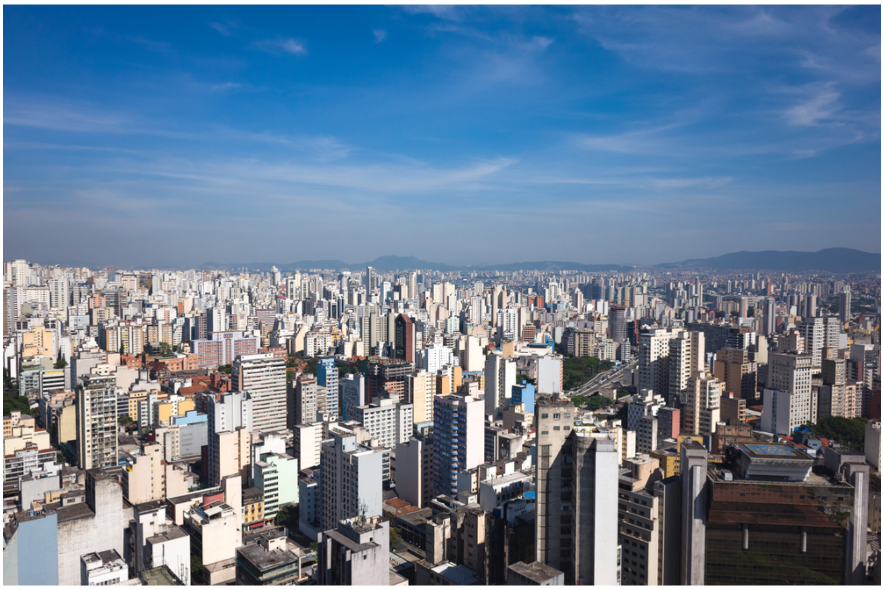

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BRL: Central bank to end its 800bp easing cycle today

Brazil's central bank, BACEN, is widely expected to cut rates 25bp to 6.25% today. This should be the final move in a cycle which started at 14.25% back in 2016. With inflation surprising on the downside our Latam economist, Gustavo Rangel, believes that BACEN easing won't be deterred by the recent sell-off in the Brazilian real. What's important for today, however, is that BACEN signals the end of the cycle. Leaving the door open for any further rate cuts would be negative in our opinion, since cheaper BRL hedging costs (delivered by both lower BRL and higher USD rates) have been contributing to the sharp rise in USD/BRL. It does also seem that BACEN has been starting to re-use USD swap auctions to slow the USD/BRL rally – and has plenty more ammunition to do this ahead of October Presidential elections. With Argentina showing some tentative signs of stability after the central bank successfully rolled Lebac securities yesterday, BRL could start to find a little support in the 3.65/70 area against the dollar.

USD: Strong policy response required to reassure EM investors

We would say it has been a combination of higher oil prices driving US rates higher, plus a weak response from some emerging market policymakers that has triggered the kind of broad dollar advance seen yesterday. Further upside could be seen to crude today if the monthly EIA oil market report confirms strong OPEC compliance to quotas in April (Saudi production seems especially low) and also a healthy rebound in US industrial production. On paper then, today could see a repeat of yesterday. However, the situation in Argentina seems slightly more stable after the central bank rolled short-term securities and EM investors still seem keen to put money to work in EM equities – even Turkey! With our rates strategy team feeling there is little to stop US 10-year Treasury yields pushing to 3.20%, momentum would certainly seem to back a further dollar advance. 94.20 seems to beckon for the US dollar index, but we suspect the advance may be hard won.

EUR: Draghi speaks at 1430CET

1-month USD OIS, priced two years forward, have risen 70bp this year. 1m EUR OIS, priced two years forward have risen 7bp. It seems unlikely the European Central Bank will change its dovish tune anytime soon (especially with the shape of the new Italian government) but the EUR 5Y5Y inflation swap has risen back to February levels and suggests the ECB may not be so immune to the oil story. We'll hear from President Mario Draghi today at 1430CET. As above, momentum is with the dollar and means that 1.1700/1720 looks possible for EUR/USD. Yet these should prove attractive multi-quarter hedging levels for those long USD.

GBP: More out-performance versus the EUR

Better earnings data keeps a Bank of England rate hike alive. EUR/GBP dip to extend to 0.8730.

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