

Brazil: Rates to stay on hold

The case for a rate hike in Brazil this year has weakened sharply



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➔ USD: An uneventful State of the Union address

President Trump's State of the Union address proved fairly uneventful, lacking major detail. While the threat of another government shutdown remains, the lack of negative rhetoric on trade should be seen as a positive for the risk environment. The focus will now turn to Fed Chair Jay Powell's speech today, but don't expect any deviation from the market supportive message communicated in the January FOMC statement.

⬇ EUR: The trend of softness

EUR/USD remains under pressure. [Soft December German factory orders](#) have added to the currency downside, with the low yielding euro seen as a good funding currency for emerging market FX longs. Look for EUR/USD to remain below 1.1400 today. In Poland, the MPC is set to stay on hold and reiterate its hike-averse bias. With inflation undershooting the National Bank of Poland's staff projections, the January headline CPI likely to decline further to 0.8% year-on-year and the expected acceleration in 1H2019 unlikely to bring the CPI above the 2.5% target, there is no reason for the NBP to tighten, particularly when growth continues to slow. The impact on the Polish zloty should be negligible as the market is pricing flat rates over the next two years.

AUD: RBA confirms market expectations - expect one off effect on AUD

The Reserve Bank of Australia's shift in forward guidance to neutral from modestly hawkish translated into meaningful losses for the Aussie dollar overnight. Yet, with the market already pricing in a partial cut within the one-year time horizon prior to Governor Philip Lowe's speech, the shift in the RBA's guidance should not be seen a material game changer for AUD and the negative effect on the currency should be rather limited. Indeed, should we see a further de-escalation in trade war rhetoric between the US and China and the Federal Reserve remains on hold in coming months, AUD should stay supported and is unlikely to break below AUD/USD 0.7000.

BRL: Rates on hold but social security reform matters more for BRL

Recent developments on inflation and activity suggest that the outlook for monetary policy in Brazil has turned more dovish in recent months and the central bank is likely to stay on hold. Indeed, the case for SELIC rate hikes during 2019, from 6.5% now, has weakened sharply. For the Brazilian real's near-term prospects, the key is social security reform. However, the Lower House President has said that plans to fast-track the reform debate in Congress are not going to work. As a result, the reform debate/approval should take longer than the market expects, lending a weakening bias to the real in the near term. In relative terms, BRL is set to underperform the Mexican peso given the less idiosyncratic risks that MXN is currently facing and stable/rising oil price from which the peso benefits.

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