Dollar strength finally meets some pushback

Speculation about a gradual end to QE in Europe may have put a floor under the euro but it's still too early to be talking about a renewed benign dollar decline

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USD: Floor under the euro and some EM tightening finally blocks dollar advance

If investing in emerging markets is effectively a leveraged position on EUR/USD strength, then investors will be welcoming this week's news that the ECB will soon be having a serious discussion over when quantitative easing ends. A floor under EUR/USD will tempt investors to look for value in some EM destinations where policymakers have responded to recent currency weakness by tightening (Turkish lira and Indian rupee) or target local stories such as Chinese A shares inclusion in the MSCI. However, the ECB story is bearish for rates and has helped US 10-year Treasury yields push back close to 3.00%. The weekend's G7 meeting will also show whether Washington wants to step back from its trade war – that seems unlikely. And next Wednesday could see a slightly more hawkish Fed. Thus it feels too early to sound the 'all-clear' on the investment environment or to be talking about a renewed benign dollar decline. That said, a break of 93.30 in the US dollar index today could see 92.80 and a Turkish rate hike could help EM in general – but stay cautious.

EUR: QE end-date discussion could see a further modest advance

News that the ECB will be discussing an end to QE next week has seen the short-end of the eurozone curve rise to levels seen before the Italian crisis hit. A much larger rise in rates (and the euro) probably requires the ECB to confirm an end date to QE. In an article published yesterday, we noted that the ECB will probably want to retain flexibility over the end date for QE until later in the year and thus it is unclear that EUR/USD, especially with a potentially hawkish Fed, has much more immediate upside above the 1.1850 area.

TRY: Market split on need to see a CBT hike, we look for 50bp

The market is split today on whether Turkey's central bank (CBT) will hike. The recent simplification of the monetary policy regime means all the focus is now on the one-week repo rate. Our team looks for a 50bp hike here. The CBT vowed to tighten policy if May inflation deteriorated. We now expect the bank to follow-through on that promise. Given the temporarily brighter international environment, USD/TRY could correct to the 4.48/50 area if the CBT does indeed hike.

BRL: Unintended consequences

One of the unintended consequences of oil producers' agreement to drive prices higher has been the 10-day truckers strike in Brazil and the backlash against the local establishment. The move seems to have benefited the more populist presidential candidates (Jair Bolsonaro on the right and Ciro Gomes on the left) and prompted an early reassessment of the outcome of October's election. Our LatAm chief economist Gustavo Rangel thinks USD/BRL could hit 4 given the current mood.

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