Escalating trade wars to be USD negative against its liquid alternatives

Our FX strategy for Thursday, and looking ahead to Mexico's central bank decision

Rate hike rise confirmation from the Fed

While the FOMC Minutes confirmed the Fed's intention to continue rising rates, in the scenario of escalating trade wars (and its impact on the US economy) the Minutes showed the central bank's preference to, within the realm of its dual mandate, put more emphasis on the deteriorating growth outlook rather than the one-off rise in the inflation. This would suggest a less tight Fed monetary stance in such a scenario and supports our view that USD would lag its liquid alternatives (EUR and JPY) due in part to the greater potential for the dovish repricing of the Fed's outlook vs the ECB and the BoJ (where both central banks still retain fairly expansionary stances – ie, both are still undergoing QE).

EUR: ECB's Sisyphean task to credibly talk down the euro

The focus is on Bundesbank President Weidmann's speech in Berlin today, which may also touch on the euro. As we discussed in our article, ECB's Sisyphean task, we expect the ECB to struggle to credibly talk down EUR as the monetary policy normalisation is underway (with the focus turning the depo rate hikes next year, as per Nowotny's comments earlier in the week) while the trade-weighted euro (which matters more for the EZ economic and inflation outlook than the bilateral EUR/USD exchange rate) has not been very strong over recent months.

SEK: Rebound in inflation to support SEK, but EUR/SEK to stay above 10.20

We look for a modest SEK recovery today prompted by the expected rebound in Swedish March inflation. Both CPI and CPIF should nudge higher, with the CPIF moving above the 2% target (2.1%YoY expected vs 1.7% previously). We look for a lower EUR/SEK, but SEK gains should be bound by the EUR/SEK 10.2000 support level, due in part to the ongoing overhang of global trade wars to which SEK is particularly vulnerable given the openness of the local economy and its leverage towards global growth (see SEK: Swimming naked?).

MXN: Rates on hold, the impact on MXN muted

As per Mexico: FX rally brings relief, Gustavo Rangel notes that the stronger peso, coupled with inflation data that, albeit still high, has been more closely in line with expectations, should give central bankers enough breathing room to pause the hiking cycle at today's monetary policy meeting. After hiking the policy rate in each of the last two meetings, Banxico should keep it stable at 7.5%. While rate cuts may be considered later this year, the room for cuts is likely to be limited to about 100bp, over the next couple of years. As an unchanged policy rate is a wide consensus, the impact on USD/MXN should be rather