FX Daily: Brazilian central bank's line in the sand

We've recently seen a step up in the pace of the central bank's FX intervention efforts, but a USD/BRL line in the sand seems to be developing in the 5.80/90 area. In addition to the intervention, the market now expects a 50bp+ rate hike by the Bank next Wednesday

Brazilian central bank president, Roberto Campos Neto

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USD: A little calm returns to FX markets

FX markets are ending the week a little calmer having negotiated the two long-dated US Treasury auctions, an ECB meeting and now President Joe Biden signing a $1.9trn stimulus bill into law.

Ahead of the main event, which is the Federal Reserve meeting next Wednesday, today sees US February PPI and the March data set from the University of Michigan. This survey contains a question on 5-10-year US inflation expectations. Typically, this doesn't move markets, but in the febrile world of bonds these days any upside surprise here could un-nerve Treasuries and lend the dollar a little support.

DXY may well have put in an important corrective high at 92.50 this week, but investors will probably want to get through the Fed before driving DXY back to the 91 or even 90 area.

EUR: Staying supported

EUR/USD negotiated the ECB's surprise announcement of front-loaded PEPP pretty well.

In practise this should see the weekly reports of ECB bond activity, starting Monday, 22 March show ECB weekly net PEPP purchases rising towards EUR 20bn from recent figures nearer EUR12bn.

As Petr Krpata writes, we don't think that is too negative for the EUR and more liquidity and bond stability certainly should help emerging market FX.

Let's see if EUR/USD can hold 1.1920 today.

GBP: Data dump is old news

Today's January UK data dump is old news yet does seem slightly GBP positive in that monthly GDP didn't fall quite as hard as expected and the trade deficit narrowed sharply, where imports fell more than exports.

Despite having come a long way already, expect EUR/GBP to say offered near the 0.8550 area.

BRL: Testing central bank's sensitivity on FX levels

There is a lot going on in Brazil right now. Sadly, new Covid-19 cases have picked up sharply since the beginning of February, forcing the government into a fresh round of fiscal stimulus. A difficult external environment for emerging market local currency bonds and local fiscal concerns had seen Brazil local currency debt under-perform this year, with 10-year yields rising 150bp+. Add in a possible return of free-spending former president Lula into next year's presidential race and USD/BRL briefly traded over 5.80 on Tuesday.

Since then, however, we have seen a step up in the pace of the central bank's FX intervention, including more direct action by selling FX spot in addition to FX swaps. A USD/BRL line in the sand does seem to be developing in the 5.80/90 area and in addition to FX intervention, the market now expects a 50bp+ rate hike by the Bank next Wednesday.

What should be a better external environment should see BRL recover this year, but for those with BRL receivables, hedging costs of 2.2% p.a. via the 3m BRL NDF seem quite reasonable and, in a volatile year, worth it.

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