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FX Daily: Round one goes to Brazil's central bank

The price action should be fairly calm in FX markets today ahead of the US labour market report tomorrow. The risks to the dollar remain on the downside. Despite the recent strength, we think it is a little early to chase USD/BRL through the major support of 4.80/5.00

Brazilian central bank president, Roberto Campos Neto

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USD: Calm before a further decline

DXY should stay close to the 90.00 level today, with meaningful moves unlikely ahead of tomorrow's US labour market report.

As long as the upcoming US labour data doesn't surprise materially on the upside, imminent Federal Reserve tightening expectations should remain at bay and allow for a gradual USD weakness. Moreover, our economists look for a modestly below consensus ADP report today, underscoring the above rationale. Thus, we expect DXY to move persistently below the 90.00 level this summer as the mix of cautious Fed. Yet, other central banks moving closer to tighter monetary stances and the global economic recovery should keep the dollar on the downtrend.

In Turkey, we expect the May inflation reading to remain high today at 17.1% (1.3% on a monthly basis). In addition, high price pressures and market concerns that the central bank may embark on earlier and more pronounced easing cycle suggests downside risks to TRY. As a result, we expect TRY to be one of the few currencies globally that will not benefit from the broader soft USD environment.

EUR: Staying close to the 1.22 level today

Little suggests that EUR/USD should move meaningfully away from the 1.2200 level today. It is a quiet day on the Eurozone data front, with final May PMIs not impacting the euro. In Scandinavian FX, we have seen some modest rebound/consolidation in NOK and SEK so far this week and look for further gains ahead as both currencies should benefit from rebounding EZ and global growth, with NOK having the added tailwind of the most hawkish central bank in the G10 FX space.

GBP: Some easing concerns about delaying the lockdown easing

After concerns that the spreading Indian Covid-19 variant may delay the 21st June lockdown easing, sterling reversed some of its prior losses as PM Boris Johnson suggested that the data doesn't point to delaying of the easing measurers. While the eventual delay cannot still be ruled out, any pushback should be just a matter of weeks given the fast vaccination process under way. The eventual impact on the economy should be limited, in turn limiting the scope for a more pronounced downside to GBP in such a scenario.

BRL: Round one goes to Brazil's central bank

The BRL has risen well over 4% over the last week and 12% since its low point in March. Back in March, Brazilian virus case numbers were rising sharply, and inflation was about to take off (latest 6.7% YoY) at a time when the Selic policy rate was only 2%.

To its credit, Brazil's central bank raised rates to 3.50% quickly and has promised another 75bp at the June meeting. Equally, the central bank undertook reasonably aggressive intervention in the spot and forwards market to keep USD/BRL below 5.80.

Driving recent strength in the BRL has no doubt been a positive re-assessment of Brazilian growth prospects. Local equity markets have seen foreign inflows for the last eight consecutive weeks and have helped drive the Bovespa benchmark index to record highs. Like South Africa, the surge in Brazil's terms of trade on the back of higher export prices is also delivering large trade surpluses.

Yet Brazil has plenty of political risk running into 2022, and while steadying, Brazil's seven-day rolling average case numbers have yet to turn decisively lower. Therefore, we think it is a little early to chase USD/BRL through major support in the 4.80/5.00 region and favour consolidation over continued BRL strength.

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