FX Daily: Fed liquidity will struggle to lift emerging markets

The Federal Reserve is addressing the tighness in US money markets with a permanent addition of dollar liquidity. But it's not enough to dampen the dollar, or lift high yielding currencies

USD: T-Bill tweak not enough to dampen dollar

In a speech last night, Fed Chair Jerome Powell said the Fed would be addressing last month's tightness in US money markets with a permanent addition of dollar liquidity – replacing several temporary open market operations currently underway. It seems this will involve the Fed buying T-Bills, perhaps worth in the region of US$200 billion. Powell was at pains to stress this was not quantitative easing. A permanent addition of liquidity could have been taken poorly by the dollar and taken well by high yield FX, but it wasn't. This because: (i) the programme will be a lot smaller than QE (which at its peak was worth US$85 billion per month), (ii) involves short term securities that can roll off the Fed's balance sheet quickly and (iii) the market is witnessing very little progress in either US-China trade or Brexit negotiations. Indeed, US-China relations seem to have deteriorated further, with the US now citing Chinese human rights abuses, in addition to the national security threat, as a reason to blacklist Chinese companies. For today, expect more tough rhetoric between the US and China ahead of tomorrow's trade meeting. Tonight also sees the release of September FOMC minutes. The Dot Plot already tells us there was much dissention over the 25 basis point cut, but poor US data since that meeting suggests it will take a lot to shake the market from its conviction (now 83% priced) that the Fed cuts again on 30 October. Expect the dollar to stay bid against activity FX and we wouldn't be surprised to see USD/CNH trading above 7.20.

EUR: Slow grind lower as EUR remains preferred funding currency

EUR/USD continues to sink lower amidst low volatility. Increasingly the euro is looking like a typical funding currency. Expect EUR/USD to drift back to 1.0925 as Brexit and trade wars cast a shadow across the region.

GBP: London and Brussels at an impasse

EU withdrawal talks are going nowhere fast. The EU's position is that Northern Ireland must remain in the customs union to avoid a hard border, while London wants to keep the UK whole and leave the customs union. Chances of a deal at next week's EU summit look virtually nil, moving us on to an Article 50 extension and elections. Expect more political risk to be priced into sterling. Cable to drop to 1.20.

MXN: Collapsing CPI opens room for deeper Banxico cuts

Mexico today sees the release of September inflation – expected to continue its collapse to around 3% year-on-year, having started the year near 7%. Given very poor domestic activity readings and two of the five Banxico board members having voted for a 50 basis point cut at the last meeting in September, a low inflation reading will encourage expectations of a more front-loaded easing cycle. Prospects of a 50 basis point rate cut at the 14 November Banxico meeting could start to weigh on the Mexican peso – especially with the US manufacturing sector showing signs of strain. We have a USD/MXN profile to 19.70 over three months, with upside risks.

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