# FX Daily: Real rate rethink

The Central Bank of Russia cut interest rates as expected on Friday. But the Bank seems to have concluded that real rates are too high. This may raise questions about whether other countries with high real rates also need a rethink

## USD: US and dollar outperformance continues

Strong employment data and resilient equities have so far kept the dollar in the ascendancy – especially as fourth quarter European data is disappointing already low expectations. So far investors are treating the coronavirus largely as a China demand shock, although in our recent forecast round, our team has taken 0.2% off our 2020 US GDP forecast, 1.7% (1.5% prior) versus new full year GDP forecasts for China, 5.6% (5.9) and eurozone, 0.7 (0.8). However, we'll have to see much clearer signs of a slowdown in US consumption, e.g. confidence indices and subsequently hard data, before the strong dollar trend turns. That said, DXY is not far from 100, which will be sure to catch the President's eye. That may prompt greater pressure on the Federal Reserve to cut rates (Fed Chair Jerome Powell delivers his semi-annual testimony on Tues/Wed this week), but that pressure may help put a lid on the dollar rather than reverse the trend. The week will also see US January CPI and the New Hampshire primary, the latter an opportunity for the Democrats to recover from the Iowa debacle. We see DXY staying bid this week, largely on the back of soft European activity data. DXY to 98.80/90.

## EUR: Fourth quarter growth challenges

After some truly appalling Germany industry data released last week, the focus this week turns to eurozone industrial production and then Germany fourth quarter GDP on Friday. On the latter, consensus sees a 0.1% quarter-on-quarter expansion, but that could easily be flat. The coronavirus and its impact on global supply chains is seen as a much bigger issue for Germany than for the US -thus EUR/USD is under pressure. We see a low at 1.0900 for EUR/USD this week. Finding some support after a few rough weeks is the Norwegian krone, where a big spike in core CPI to 2.9% will likely see Norges Bank keep rates at 1.50%.

## GBP: Reality bites

Cable is dipping under support at 1.2900/2920 and risks 1.2735/65 as the difficult reality of the post Brexit UK-EU relationship fully dawns.

## RUB: CBR's change of approach fires up bond market

The Central Bank of Russia cut the policy rate to 6.00% as consensus had expected on Friday, but notably the press conference sounded dovish. As Dmitry Dolgin writes, the CBR looks to have concluded (perhaps with some help from the government) that real rates are too high. We now see an extra 50 basis points of easing emerging through the first half of this year, while the CPI trajectory allows. The move could help 10 year OFZ yields to press the 6% area, but with a flat yield curve, foreign investors will have very little interest in hedging the rouble exposure. Thus, this dovish shift looks neutral for the currency. It may also raise questions whether other countries with high real rates may require a re-think. Mexico is the standout here and with a weak growth profile here, we think the Mexican peso is now seeing its best levels for the year.

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