

FX Daily: Scaling back the prospects of more easing by Mexico's central bank

After the volatility seen last month, market expectations of a rate cut by Mexico's central bank have been scaled back. We think an unchanged policy may be the safer bet now that inflation expectations have been pushed to the highest level seen since summer 2018. Expect a stronger MXN later this year



The Bank of Mexico

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USD: A big test of the DXY 200-day moving average resistance

DXY is testing the key 200-day moving average resistance level at 92.63, with the dollar up against all G10 FX overnight despite stabilising Asia equity markets and equity futures pointing to a modestly higher European open. With Europe battling a third wave of the pandemic, near-term risks are skewed to a higher dollar and further rises in DXY.

It is a very quiet day on the US data front, with the final estimate of Q4 GDP likely to have a fairly limited impact on the dollar.

⬇️ EUR: As the EUR struggles, all eyes on the Swiss central bank

EUR/USD continues struggling, with 1.1750-1.1800 being the next key test area for the cross.

The Swiss central bank holds its quarterly monetary policy meeting today. Swiss 2020 GDP contracted by -3% rate, which was expected by the SNB at its last meeting in December, suggesting it may not err much from its 2.5-3.0% forecast for 2021.

Let's see whether the central bank still describes the CHF as 'highly valued'. Probably, since the CHF nominal trade-weighted index has not corrected much lower at all.

Overall, we suspect EUR/CHF can hold 1.10 support on today's event risk.

➡️ GBP: Despite recent woes, GBP short-term fair value has improved vs EUR

While GBP has struggled lately, we note that its short term financial fair value has improved vs EUR over the past two weeks, by more than 1%. Similar dynamics were observed in EUR/USD, where its short-term fair value has declined lately, clearly pointing to EUR issues (as its fair value deteriorated).

With EUR/GBP no longer being meaningfully undervalued (in fact now close to its fair value of 0.8640), this opens the door for further eventual declines in the cross towards our target of 0.8500. Short-term valuation is no longer a GBP headwind.

⬆️ MXN: Further easing prospects scaled back

Mexico's central bank meets today and after the unanimous rate cut to 4.00% in early February, the market had toyed with the idea of a further 25 basis points rate cut today.

Those expectations have been scaled back after the volatility seen last month, with MXN 4% weaker, and 10-year MBONO yields +130bp as the market moves to price a 50-75bp tightening cycle later this year. As to what Banxico will do, an unchanged policy may be the safer bet now that inflation expectations (from the 5-yr inflation linkers) have pushed up to 4.17% - the highest since summer 2018.

At the same time, the central bank may want to push back on tightening expectations, having so openly discussed further easing in 2021. What does this all mean for the MXN? Well, a commodity-linked currency, exposed to strong US demand and set for strong remittances in 2021 (worth 3.8% of GDP in 2020) favours a stronger MXN later this year. USD/MXN rallies may stall at 21.10/20.