FX daily: The Fed cut helps risk more than it hurts the dollar

It's all about rate cuts from both the Fed and Brazil's central bank today. But we think the Fed cut will be more helpful for the risk environment and less harmful for the dollar against low yielding currencies in Europe and the JPY.

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USD: 25bp cut fully priced, little guidance expected

The Federal Reserve is widely expected to cut rates by 25 basis points later today and maintain language that keeps the door open for further cuts. A much deeper easing cycle after today's cut is certainly not priced in - the market is struggling to price in the next 25bp cut before March 2020, thus any dovish language could send US rates and the dollar lower. However, we suspect the Fed cut today will be more helpful for the risk environment (perhaps helping the 2-10 year Treasury curve to steepen some more) and less harmful for the dollar against low yielding currencies in Europe and the JPY. After all, bond investors in those two regions are still being crowded out of local debt markets by quantitative easing schemes and into higher-yielding US debt, plus are still faced with very expensive dollar hedging costs of c.2.5% pa. We think that not until those hedging costs have fallen another 50-75bp will Fed easing start to impact EUR/$ & $/JPY. Ahead of the FOMC, we'll also see US GDP and the ADP, where any downside surprise could briefly hit the dollar. DXY 97.50-98.00.

EUR: Focus on German unemployment today

Newly crowned ECB President Christine Lagarde is already calling on Germany and the Netherlands to use their budget surpluses to support growth. The path to this outcome (were it to happen) probably lies via higher German unemployment first. So we'll be keeping a close eye on today's German market labour data. It's tempting to say the dollar is broadly turning and EUR/$ should trade higher - but we've been here many times before. We favour the 1.1030-1.1145 range.
GBP: 12 December will be the day
Brexit is off the table (temporarily) and the focus switches to a 12 December election and whether PM Johnson can do any better than his predecessor in turning poll ratings into a majority. We have a slight bias in Cable towards 1.27.

BRL: Widely expected 50bp cut from Brazil today
In a rare bout of unanimity, all 47 analysts polled by Bloomberg expect BACEN to cut the policy rate 50bp today to 5.00%. As our Latam Chief Economist, Gustavo Rangel writes in his preview, inflation and inflation expectations are well contained and the policy rate could be cut as low as 4.00% in 1Q20 (4.25% is now priced by the market.) The issue today will be how much appetite BACEN has for further cuts. With the BRL performing well on expected privatisation inflows later this year, BACEN may well indeed take the opportunity to signal deeper easing. This should be good news for the local bond market (Brazil has the third-largest weight in EM local currency bond indices) and as we saw with deep easing in Russia last week, the currency can stay supported. Expect BRL to outperform its forwards.

Read our preview for Brazil’s central bank meeting

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