

## FX: Enjoying the Powell pause

Comments from Fed Chair Jay Powell have pushed the dollar lower and the euro higher, though the threat of auto tariffs has kept the single currency's gains in check. The pound, meanwhile, is taking 'Project Hysteria' in stride



Fed Chair, Jerome Powell

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### ➔ USD: Powell's comments give risk assets a reprieve

Comments from Federal Reserve Chair Jay Powell that the Fed Funds rate was 'just below' estimates of the neutral level have seen US rates and the dollar soften, providing another window of relief for emerging market assets. The market is now pricing in a 60% chance of a Fed hike at the 18 December meeting and just one more hike next year (March). US swap rates are now about 20-25 basis points off their highs earlier this month, similar to the kind of correction seen in May this year. While this correction may have a little further to run, our team prefers to stick to the view of three Fed rate hikes next year, suggesting this drop in US rates and the dollar will prove temporary. Expect much scrutiny of tonight's FOMC minutes, but we'd also assume that the Fed will retain its median expectation of the Long Run neutral rate at 3.00% at its December meeting, re-opening the door on a more aggressive Fed tightening cycle for 2019. We doubt that the dollar has to fall too much more against the low-yielders (especially given the backdrop of US tariffs being considered on auto imports), which probably means that the heavily Europe-weighted DXY finds support ahead of the 96.00/50 area.

## ⬇️ EUR: Is that all?

EUR/USD has seen a modest rally on the Powell remarks, but investors are understandably not getting carried away. The existing steep forward curve already makes it expensive to sell dollars and the view that hedging costs may not get too much worse is hardly a good reason to sell the dollar. In fact, we are more worried about the discussion on US auto tariffs. The US Department of Commerce is [currently conducting a Section 232 investigation](#) into auto imports. The findings, due anytime, could easily find that remedial action needs to be taken – largely against the likes of Japan and Germany – since Canada, Mexico and Korea look covered by other deals. Such a finding would likely give the US a big stick to use in discussions over a US:EU trade deal, but the EUR could be a casualty in the meantime. We haven't seen anything to suggest that EUR/USD needs to break out of a 1.12-1.15 trading range and suspect that any rallies above 1.1400 area prove short lived. Look out for German November inflation today and presumably a weak eurozone economic confidence figure.

## ➡️ GBP: Unmoved by 'Project Hysteria'

The British pound has taken the Bank of England and Treasury Brexit scenario analyses in its stride and is probably more interested in politics right now. The fact that arch-Brexiteer Angela Leadsom supports May's deal could be helping the pound. Expect much more GBP volatility ahead of the 11 December vote.

## ➡️ MXN: Banxico keeps MXN well-positioned for a pause.

Policy rates of 8% in Mexico mean that the peso is well-positioned to take advantage of any Fed pause. EUR/MXN could drop to 22.60 if this story builds.

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