

Mexico's Banxico to decouple from the Fed

A resolution to the Nafta impasse should give Mexico's central bank (Banxico) the final green-light to decouple its monetary policy from the US Federal Reserve today. Here's what that means for the peso. Plus, our thoughts on other emerging markets after a jump in US Treasury yields



⬆️ USD: Higher US funding costs send dollar up across the board

Risk assets have taken a hit overnight as the rise in US Treasury yields (10y UST breaching the 3.20% level for the first time since 2011) uncovered the fragility of the recent rebound in risk assets and underscore concerns that US funding costs should remain a clear non-supportive factor for emerging market FX (with the risk of eventual re-escalation of trade war rhetoric and the long list of idiosyncratic EM risk events in the remainder of the year being potential negatives for this currency segment). For these reasons, we remain very cautious on EM FX going into year-end and caution against chasing USD/EM FX crosses lower.

⬇️ EUR: Below the EUR/USD 1.1500 level yet again

Despite the stabilisation in BTPs and the 10y BTP-bund spread being back below the 300 basis point

level, the pro-cyclical EUR/USD broke below 1.1500 in response to the negative general risk environment. With long-term investors likely treating EUR/USD dips as a buying opportunity, this should prove a cushion to the euro. In the central and eastern European space, we see yesterday's Czech koruna rebound as short-lived and look for further EUR/CZK upside due to the CNB policy outlook being fairly priced in, koruna year-end seasonal weakness and the fragile risk environment. We like to fund CZK short via long RON given the leu's high carry and the managed nature of the currency.

➔ **GBP: Focus now shifts to Brexit talks and Irish border backstop risks**

With GBP navigating the Tory Party Conference event risk relatively unscathed, the primary focus will now be on making actual steps towards finalising a Brexit Withdrawal Agreement in the run-up to the October EU summit (18-19 Oct). It may be wishful thinking to get a signed deal in the next month – but we believe GBP will be particularly sensitive to any headlines suggesting that either the UK and/or EU are willing to make concessions on the Irish border backstop impasse. Watch for such headline risks potentially dragging EUR/GBP down towards 0.88.

⬇️ **MXN: Nafta gives Banxico the green-light to decouple from the Fed**

As per our [Banxico preview](#), Gustavo Rangel notes that the resolution of the Nafta impasse should give Mexico's central bank (Banxico) the final green-light to decouple its monetary policy decisions from the US Federal Reserve today. This is because the US-Mexico-Canada Agreement sharply-reduced uncertainties regarding Mexico's political and external trade outlooks have resulted in a considerable improvement in the balance of risks for Mexican financial assets. As a result, Mexico's longer-term risk-profile for inflation has likewise improved. A “hawkish hold” is much more likely than an “all-clear” signal for a rate cut. With the consensus moving towards the on-hold decision, the hawkish hold should be, on its own, marginally supportive of the Mexican peso today (other things equal). Yet the risks are for higher USD/MXN given the fragile risk environment.