

Risk rally pauses for breath

After a strong start to the year, emerging markets are starting to hand back some gains. But one currency stands out from the crowd



⬆️ USD: Strong demand for EM may take a short term pause

The dollar is performing well across the board and after a strong start to the year, emerging market FX is starting to hand back some gains. We've already seen a surprise cut from India today and in other meetings (Philippines, Czech Republic, Romania and Mexico) investors will be looking out for a dovish shift or signs of political interference. After [a loose budget](#) announced last week in India and in the face of stubbornly high inflation, the RBI move was indeed a surprise. Our Asia team sees USD/INR at 73. For Mexico's Banxico today, [Gustavo Rangel](#) believes it's too early for the bank to switch to a dovish stance. Banxico's very credible stance over recent years and its high carry should see the Mexican peso retain its status as an outperformer. With activity doubts intensifying across Europe and emerging markets looking a little softer, we could still see DXY advancing to the 97 area.

⬇️ EUR: Weakness in Germany is undoubtedly playing a role here

Another day, another piece of terrible German data – this time December industrial production. One of the key supports to EUR/USD is probably cheap levels (e.g. one and two year outright forwards at 1.17 and 1.20 respectively). But EUR/USD risks a move to 1.1300/1310 and we're

certainly seeing CE4 soften on the German slowdown. Given the uncertain external environment and the recent soft domestic Czech data, [we expect the CNB to stay on hold today](#) leading to further weakness in the overbought Czech koruna. In Romania, the central bank's stance on the bank tax will be in focus.

↓ GBP: To hell in a handcart

The Bank of England meets to set interest rates today and as [James Smith writes](#), the BoE will likely keep policy unchanged and strike a note of caution. Though wage growth is strong, decelerating domestic demand ahead of the 29 March Brexit deadline should keep the BoE on the sidelines – and the 15 basis points of tightening priced this year could come out of both the money market curve and sterling. Prime Minister Theresa May is in Brussels today, but expectations of any EU concessions are virtually nil. GBP/USD risks another leg lower to 1.2830 as May runs down the clock.

↓ ZAR: The Eskom conundrum

Having been a top 2019 FX performer, the South African rand faces event risk from today's state of the nation address by President Cyril Ramaphosa. Emerging market sovereign strategist, Trieu Pham, expects the speech will be closely observed for comments on Eskom. President Ramaphosa's reference to Eskom as "too big to fail" could also imply a cash injection or a debt transfer to the government as proposed by the utility [in early December](#). A materialisation of contingent risks for the government without any feasible turnaround strategy would imply downward pressure on South Africa's last remaining investment grade rating at Moody's (Baa3 stable). Given some dollar strength emerging in the very short term, any misstep by Ramaphosa could send USD/ZAR to 14.00.

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