USD: The best of both worlds

Risk-off or risk-on, the dollar doesn't seem to mind

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USD: Enjoying the best of both worlds

Despite the meaningful decline in US Treasury yields and a further narrowing of the front-end US – G10 FX average interest rate differential, the US dollar continues to benefit across the board. At this point, the dollar's allure is defined by the currency enjoying the best of both worlds. In bad, risk-off times (the current situation) the dollar benefits from safe haven properties and its reserve currency status (which more than offset the decline in UST yields). In good times, its meaningful carry (which, after the recent decline, is still well above of those of the euro or Japanese yen) does not make USD an attractive funding currency. This in turn does not put large pressure on the dollar during risk-on days (in contrast to what has been the case in previous years). With EUR/USD set to move to 1.10 in June, DXY is to converge to 99.0. Data-wise, we expect the second estimate of 1Q US GDP to confirm the initial solid reading of 3.2% quarter-on-quarter annualised.

EUR: The downward trend in place

The lack of meaningful eurozone data this week continues to mean that EUR/USD is primarily driven by the general risk environment and the dollar side. As per above, the strong USD environment suggests a further downside to the cross. In Poland, the minutes of the May MPC Meeting shouldn't bring any surprise, with the board committed to keeping rates stable this year and next. With EU elections behind us, the prime driver of the zloty is the external environment.

MXN: A slight delay to the emergence of a more dovish consensus

In Mexico, the focus turns to the Banxico minutes. While economic activity data has disappointed, the temporary spike in the inflation rate, to 4.4% year-on-year, should delay slightly the emergence of a more dovish consensus inside the board. Still, we expect the Banxico to start its easing cycle in 4Q19. This should provide partial support to the peso via bond inflows, though the risk of trade wars is posing downside risk to MXN and emerging market FX in general (as well as creating a risk of further delay to the start of Banxico easing cycle if MXN comes under pressure).

BRL: Weak GDP to have limited impact

In Brazil, markets await 1Q GDP today. The bar for negative surprises appears quite elevated, with investors broadly positioned for a very weak reading: the YoY gauge is expected to drop to 0.5% (prior 1.1%) and the QoQ to creep into negative territory. Nonetheless, expectations for key economic reforms in the country have been revamped of late, driving USD/BRL below 4.00. We expect the reform outlook to remain in the driver's seat for the time being and to broadly offset possible data disappointment stemming from weak GDP numbers. We therefore see USD/BRL linger around the 4.00 level on the day.