USD: Overly dovish mispriced Fed

Today's US jobs report should reinforce our view that current expectations for Fed rate hikes next year are too low

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USD: Overly dovishly mis-priced Fed

The key data point of the day is the US November employment report. As per our NFP Preview, our economists expect payrolls to rise strongly (200K). Unemployment is set to remain at a 49-year low, causing upward pressure on wages. We look for wage growth to stay at 3.1% this month but, given growing evidence of pay pressures in various surveys, wage growth is likely to pick up again in coming months. This should, in our view, keep the Fed on track in terms of future rate hikes and support the US dollar in the early part of the next year (when we expect the dollar to peak, see 2019 FX Outlook), particularly in the context of the current overly dovish market pricing of the Fed. After the latest decline in US Treasury yields, the market is not even pricing in one full rate hike for 2019 (on top of the 25 basis point hike later this month). The eventual re-pricing, the rise in front-end UST yields, UST curve flattening and its short-term inversion should be the catalyst behind the last leg of USD strength in the current dollar bull cycle.

EUR: Bar for EUR/USD sustained strength is high for now

It took close to a 10 basis point decline in 2-year US Treasury yields to briefly push EUR/USD temporarily above 1.1400. Such a fairly limited EUR/USD reaction in the context of such a large drop in short-end US rates underlines the high bar for EUR/USD to move sustainably higher. As discussed in our 2019 FX Outlook, we expect EUR/USD to first move to 1.10 in 1Q19 before recovering to 1.20 by the year end.

CAD: Uninspiring wage growth to reiterate BoC dovish message

Canada's November average hourly wage growth has been declining since June. Another uninspiring wage growth number should reiterate the dovish bias of this week's Bank of Canda meeting and be modesty negative for the Canadian dollar, particularly if no substantial cuts to production are agreed by OPEC+ today (Crude oil: Crunch time for OPEC+).

Latam: Inflation to be more supportive of MXN vs BRL today

In Brazil, ING's Chief Latam economist Gustavo Rangel notes that inflation has surprised to the downside recently while announced cuts to electricity prices added further downside to November and December numbers. This means that Brazil could end 2018 with sub-4% inflation, which consolidates a more dovish outlook for monetary policy. Mexico's experience is an interesting contrast - concerns over the FX pass-through following the ongoing selloff add material upside to an already uncomfortable inflation outlook, forcing the central bank to change tactic once again and return to a hawkish 'follow-the-US Fed' policy stance. On the margin, inflation should be more supportive of the Mexican peso vs Brazilian real today given its more hawkish implication for Banxico, but general risk environment remains the key driver.