

USD: Strong performance

The dollar has taken threats to shut down the US government in stride



US President Donald Trump

➔ USD: The dollar is holding up well despite low-level political noise

On another day, comments by the US President that the Federal Reserve would be "foolish" to raise rates at a future meeting or threats to shut down the government would not be taken well by the dollar. As it is, the dollar has taken the news in stride – largely because it has become very difficult to separate the noise from the signal in current markets. Another case in point: does China's offer to rescind its retaliatory tariffs on US auto imports represent a real breakthrough or merely temporary calm?

The very modest improvement in Chinese assets (Shanghai Composite +0.31%, and USD/CNH -0.2%) suggests investors will need a lot more convincing before taking major re-allocation decisions. For today, we'll be focusing on the November US CPI numbers. We look for a consensus rise in the core rate to 2.2% and over coming months expect core to be rising to 2.5%. That drives our core story that the market is underpricing Fed tightening and the dollar will go higher still. Indeed, there are some signs that the recent correction/over-reaction in US money market rates has run its course. We expect DXY to test and break the highs of the year at 97.69 shortly.



EUR: Now we're focusing on the French: German bond spread

EUR/USD is staying soft as investors shift their focus from the BTP: Bund spread to OAT: Bund spread. The latter has now widened close to 50 basis points and is back to levels before French President Emmanuel Macron took office – as markets digest the prospect of a 3.4% French budget deficit for next year. This will complicate Italian budgetary discussions, where there is also now talk of early Italian elections in March. Low growth, negative rates and political uncertainty bodes ill for the euro. We can see EUR/USD sinking back to 1.1270 and maybe 1.1215 in thin markets.

↓ GBP: PM May will face leadership challenge tonight

UK Prime Minister Theresa May is set to face a vote of confidence in her leadership later today. Much uncertainty could sink Cable to a near-term target of 1.2350.

➔ BRL: Central bank guidance to shift from hawkish to neutral

Brazil's BACEN meets today to set the selic policy rate. No change is expected in the 6.5% rate, but as Gustavo Rangel notes in his [recent report](#), BACEN will probably shift to a neutral from hawkish stance. The balance of risks to the inflation outlook has become more symmetric and the recent stability in the Brazilian real has seen the market scale back tightening expectations for next year. That said, the market still prices in 125 basis points of tightening and we could see that being priced out were social security reforms to advance in early 1Q19. We prefer to see the glass half full in Brazil right now and even though a pick up in US rates could lift the dollar into year-end, we see BRL quite well insulated at 3.90/4.00/USD.

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