

Daily FX Strategy: Fed loath to disappoint, risk assets may benefit

It will be hard for the Federal Reserve to match the market's extremely dovish expectations today but we suspect it will carefully choose its language so as not to disappoint too much



How far will Fed Chair, Jerome Powell, push back market expectations?

➔ USD: Fed to cut by 25bp and leave the door open for more

The FOMC announces its decision on monetary policy at 1900 GMT tonight. [Our call is for a 25 basis point rate cut](#), which is in line with the prevailing market view (87% implied probability) and should be justified by the growing risk of a global economic slowdown, trade tensions and a benign inflation backdrop. The “grey area” between market expectations and the Fed’s intentions will likely be clarified by the FOMC forward-looking language. Currently, the OIS curve shows 63bp of easing priced in by 4Q19 and 94bp by 4Q20. Matching such extremely dovish expectations seems like a hard challenge for the Committee. Nonetheless, from a tactical point of view, Fed Chair Jerome Powell has no interest in under-delivering and thereby dampening equity markets, as it would likely attract even more pressure from the White House. In turn, we suspect that the FOMC will carefully choose its language so as not to disappoint expectations, therefore keeping the door open for additional easing. The question remains whether this will be enough to avert a major repricing in rate expectations. It is indeed a tight call, but we believe the Fed will probably find a way to keep risk assets supported, although we do not exclude a marginal upside correction in front-

end rates and a flattening in the yield curve. On balance, we expect high-yielding risk-sensitive currencies to outperform, although the US dollar may prove broadly resilient against other currencies.

⬇️ EUR: Cannot exclude a break below 1.11

EUR/USD has been surprisingly resilient to the dovish message delivered by the European Central Bank last week. However, 2Q GDP and July CPI released today at 1000 GMT, should both edge lower, thereby supporting expectations that ECB President Mario Draghi will “go out with a bang” in September. As we also expect no significant USD weakness after the Fed announcement, EUR/USD may soon break below 1.1100.

➡️ GBP: Some respite before the BoE

Yesterday, sterling managed to find some respite after the sharp fall seen earlier this the week. As we approach the Bank of England meeting on Thursday, markets may opt for a wait-and-see approach. In turn, GBP may be spared another massive selloff today and we should not see a break above 0.9200 in EUR/GBP just yet.

⬆️ CAD: The best bet ahead of the Fed?

Should the Fed announcement push the value of high-yielding risk-sensitive currencies today (see above), we expect the Canadian dollar to represent a more attractive option than its peers, the Australian and New Zealand dollars, given that the Bank of Canada's neutral stance (contrary to the dovish Reserve Banks of Australia and New Zealand) ensures a more supportive rate outlook. The release of May GDP (1330 GMT) should be broadly in line with expectations and have limited impact on USD/CAD, which may retract below the 1.3100 level.

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