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Article

FX: A Fed stuffing

That old-age cliché of the holiday season being a time for reflection couldn't be more apt to describe the past week in global markets

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USD: Fed policy would be lower than it is under a price-level target mandate

Investors have been given the opportunity to reflect on Fed policy after the central bank released the minutes of its November meeting. And while the default in recent years has been to view policy decisions of the world's most influential central bank over a three-month (or so) rolling window, it appears as though such short-termism is unlikely to be the optimal way to view Fed policy going into 2018. Indeed, when we read the latest minutes – and see the diverse range of views over crucial big picture issues facing the US economy – the risks of major shake-up in the Fed's policy framework next year remain fairly high.

While the White House could be the catalyst here, in that they still have the luxury of appointing four new FOMC members, we suspect changes may be more nuanced. For example, we may start to see a change in the way in which the Fed communicates its 'symmetric inflation target' – and this has been fairly evident in recent months, with some officials raising concerns that markets may be misinterpreting the Fed's intent here.

Structurally low US inflation has been the prevailing theme in recent years and this has led the likes of former Fed Chair Ben Bernanke (and others) to float the idea of 'temporary price-level targeting'. While we initially saw this as more of a thought exercise, our eyes did light up when we saw 'price-level targeting' being briefly discussed in the latest minutes – especially given our more bearish USD view.

Out of curiosity, we simulated where the Fed funds rate would be had the central bank pursued a 2% price-level target since 2009; this chart shows that policy rates would be slightly lower than they currently are, simply owing to the fact that the Fed have failed to make up for 'lost inflation' since the financial crisis. While one may see any shift towards price-level targeting as radical, we do think such analysis helps to understand why the Fed has inherent dovish concerns, and why global markets can afford to remain bearish on US rates and the dollar.

EUR: Eurozone data continues to defy the odds

As our economists note, the minutes of the October ECB meeting point to broad support for the taper decision but some disagreement on whether or not the QE extension should be open-ended. Nonetheless, EZ data continues to outperform; the November PMI figures support our view that the economy will sustain solid growth into year-end with the potential for further acceleration. This story will provide a buffer to the EUR amid some short-term political noise, with a 1.18-1.20 near-term range for EUR/$ likely now.

German IFO data should print fairly decently. In Sweden, there's October producer price inflation to note; a softer reading may see some disinflation sentiment return in SEK markets, although the more pertinent data focus will be next week's 3Q GDP (Thu). Neutral EUR/SEK bias around 9.85.

ZAR: A big moment for South African markets as junk status may be looming

As we've been flagging all this week, we'll get a big decision from the sovereign rating agencies today over the status of South African local currency bonds. We still think the risks of both an S&P and Moody's downgrade are high – and as such think the direction of travel for USD/ZAR is towards the 15.00 level.