

## FX Daily: A dovish 25bp Fed cut to offer only short-lived respite to dollar

Our economists are calling for a 25bp cut by the Fed today, but admit it is an exceptionally close call. Markets are narrowly favouring a 50bp reduction. The dollar should rally on a 25bp move. However, if Powell and Dot Plots are as dovish as we think, dollar gains may soon prove unsustainable



We expect the Fed to cut by 25bp, but offer dovish signals

### USD: We expect a dovish 25bp cut today

Today's Fed rate decision (1900 BST) is as close as it gets. Markets have recently leaned narrowly in favour (65%-35% implied probability) of a 50bp cut rather than 25bp. Our [full preview](#) of the September FOMC explains why we called for 25bp last week. Admittedly, after recent media reports and the market pricing in a greater chance of 50bp, this is now an exceptionally close call.

We discussed in yesterday's [FX Daily](#) how a 50bp cut may well be the consequence of the market itself having given the Fed the last push to a larger reduction via dovish repricing. You can easily see the key risk for the Fed here: Chair Jerome Powell would need to provide solid macro justifications for a half-point move to avoid sounding too sensitive to market rate expectations. Incidentally, Powell would need to show the 50bp cut isn't a "panic" move: i.e. the Fed is not overly worried about recession and the jobs market. Failing to offer such reassurance can cause turmoil in

equities.

As discussed, we see 25bp as slightly more likely. However, we believe the Fed would accompany a more cautious cut with dovish messaging. That could include a few members voting for 50bp and Powell opening the door to larger cuts ahead. Dot Plot rate projections will be a major communication channel. We expect the median value to be revised to signal a total of 75bp of easing this year and a further 125bp next year. That would fall short of the 115bp and 135bp priced in by the markets for 2024 and 2025, but if paired with a dovish press conference, the projection will hardly prevent any dovish deviations moving on.

A 25bp cut will likely lead to a dollar rally due to a mechanical shift higher in the OIS curve. However, if we are right with our expectations of a dovish press conference by Powell, the dollar may well struggle to hold on to gains beyond the very short-term.

*Francesco Pesole*

## 📉 EUR: Correction today, but rebound later

There are no major data releases in the eurozone today, and we expect EUR/USD to trade in tight ranges until the FOMC announcement this evening. The transmission channels from the Fed cut to EUR/USD are the USD short-term rate impact first, and the equity reaction second. If the Fed cuts by 50bp and markets read that as a panic move, USD weakness may be channelled via EUR, JPY and CHF, while higher-beta currencies (like NOK and SEK) may take a hit.

In our base case (dovish 25bp cut), EUR/USD moves back below 1.110, but gradually recovers ground in the coming days. By the time the next big things happen in markets (US PCE, US jobs report), EUR/USD may be back at 1.11-1.12.

On the ECB side, another hawkish-leaning Governing Council member, Gediminas Simkus, said that an October cut is unlikely. Markets are only pricing in 7bp, and we also expect the next reduction in December. That said, if the Fed cuts by 50bp today, there will be growing pressure on the ECB to frontload some easing as well.

*Francesco Pesole*

## 📉 GBP: Inflation confirms no cut tomorrow

UK inflation for August came in perfectly in line with consensus this morning. Headline CPI was unchanged at 2.2% YoY, while the core index accelerated from 3.3% to 3.6% as expected. The closely-monitored services inflation also accelerated in line with consensus, from 5.2% to 5.6%.

This morning's numbers all but confirm that the Bank of England [should keep rates on hold tomorrow](#). There is a residual 6bp of easing priced though for the meeting, suggesting a bit more room for short-dated Sonia swap rates to readjust higher, after falling throughout September.

The pound is trading on the front foot after CPI data and may find a bit more support tomorrow. That said, the FOMC event today may be a bigger event for GBP markets. A 25bp cut can send GBP/USD back below 1.3100, but if Powell is as dovish as we expect, Cable may well find good support before touching the recent 1.3015 lows.

*Francesco Pesole*

## ➔ CEE: More cuts discussion

The rather quiet atmosphere of this week should continue today in the CEE region. The calendar has nothing to offer but we have several speakers scheduled in the region today. The Czech National Bank (CNB) blackout period will start this afternoon ahead of next week's Wednesday's meeting. Potentially we may hear something from board members, however it seems that a 25bp rate cut to 4.25% is a safe call. The question remains what to expect next?

Our economists are on the hawkish side with a pause in the cutting cycle in December and February with 3.75% at the end of the first quarter while the market is pricing in 3.25%. Still, in the short term, we find market pricing justifiable given the weaker economic numbers. On the other hand, the terminal rate at 2.75% priced in goes against the CNB's main tone at the moment. We think this could be a source of support for the CZK next week. EUR/CZK bounced down from 25.150 yesterday, although this was our view, our reasons have not yet materialised and the rate differential remains rather lower. So the real trigger is more likely to be the CNB meeting next week.

In Hungary, the prime minister is scheduled to address the European Parliament today, which may trigger some headlines. EUR/HUF is almost fully back to pre-fiscal headlines levels from last week and although we still see some room to the downside, the main potential is gone. On the other hand, next week's National Bank of Hungary meeting is scheduled which will significantly hinge on the Fed's decision today in our view. However, our economists see a 25bp rate cut as the baseline, which, if the Fed is dovish, could promise more rate cuts in the future, leaving the HUF exposed.

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