

FX Daily: A pre-scripted FOMC meeting, but watch the 2024 dot plot

Markets have already written the script for the Fed today: a hawkish hold, an unchanged 2023 dot plot. We see no reasons for the FOMC to diverge from these expectations, and any FX action would depend on potential revisions to the 2024 dots. This should be a USD-supportive outcome, beyond any short-term reaction. A BoE hike tomorrow is in doubt after a CPI miss



Jerome Powell, Chair of the Federal Reserve

➔ USD: FOMC won't be a huge event for the dollar

Federal Reserve day is here, and the spectrum of consensus and market expectations appears to be rather small, especially when compared to last week's European Central Bank meeting. The chance of another rate hike today is close to zero, both according to economists and the market, so all attention will be directed to the updated economic forecasts, and in particular to the dot plot rate projections.

Back in June (the latest dot plot update) 12 FOMC members pencilled in another rate hike for 2023. As discussed in our [FOMC preview](#), we think the median dot will continue to signal an additional 2023 hike, given the recent data flow on US activity data, as well as the recent blip in the

disinflation path. Even more importantly, this is where the overwhelming majority of market expectations seem to sit: failing to signal another hike in 2023 would be read as a rather strong dovish message, and convince markets to price out the residual 11bp of tightening left in the USD OIS curve. This is an undesirable outcome for the Fed, especially after the latest inflation print cast fresh doubts on the smoothness of the disinflation process.

The 2024 dot plot is where things could get more interesting, especially in terms of the FX market impact. Our economist expects the median projection to remain unchanged at 4.64%, therefore continuing to signal 100bp of cuts next year. Given the resilience of the economic outlook and a reinforcement of a higher-for-longer narrative, there is a non-negligible risk of the 2024 median dot being revised higher. Elsewhere, we expect the statement to be changed only marginally, keeping a reference to ongoing rate increases that “may be appropriate” and Fed Chair Jerome Powell willing to keep all options open at the press conference. The usual pushback against rate cut expectations (which have been scaled back recently) should be part of the script too, especially if not signalled by a 2024 dot plot revision.

The overall message by the Fed should be supportive of the dollar: keep the door open for more tightening if needed and do anything to dent the idea that rate cuts are a long way out. However, market expectations appear quite condensed around this script. As mentioned, the 2024 dots are where there is a bit more room for uncertainty: leaving the 2024 dot unchanged may not be enough to trigger a material USD correction (perhaps leaving USD largely unchanged, if matched with Powell's verbal rate-cut pushback), but higher 2024 dots can translate into another USD leg higher. Beyond the short-term impact, we don't expect this meeting to be a game changer for the dollar, as the focus will remain on US activity data.

Elsewhere in the world, keep an eye on New Zealand's GDP figures tonight. The consensus is expecting the country to have re-emerged from recession in the second quarter with 0.4% quarter-on-quarter growth: this can help NZD/USD stabilise further.

Francesco Pesole

➔ EUR: Might slip back to 1.0600 in a hawkish Fed surprise scenario

EUR/USD enjoyed a short-lived rally yesterday, but markets are probably holding on to their dollar positions ahead of a likely hawkish hold by the Fed – and risks of 2024 dot plot revisions, as discussed above – meaning that the pair may be capped into this evening's risk event.

There are also no data releases in the eurozone (except for construction output figures) today and no scheduled ECB speakers. The divergence between a dovish hold in the eurozone and a hawkish hold in the US should continue to thwart EUR/USD rebound possibilities, but our base case is that today's meeting will not leave the pair trading very far from 1.0650/1.0700. A 2024 dot plot upward revision and a more hawkish than expected outcome throughout should see it slip back below 1.0600. Ultimately, US data should be back in the driver's seat in no time.

Francesco Pesole



GBP: Big CPI miss makes tomorrow's BoE meeting an even closer call

A huge miss in UK inflation this morning is casting serious doubts about whether the Bank of England will hike rates tomorrow. Headline CPI decelerated from 6.8% to 6.7% in August, despite expectations of a rebound to 7.0%. Most importantly, core inflation slowed significantly, from 6.9% to 6.2% (consensus was 6.8%). Service inflation, which is the gauge the BoE is mostly focused on, fell from 7.4% to 6.8%, which is below the bank's own August forecast. Most of the decline is due to airfares and package holidays (quite unusual in August), but progress was made in other parts of the economy.

As discussed in our [BoE preview](#), this meeting was already a close call: the surprise drop in inflation makes tomorrow's announcement even more interesting. Still, our economics team continues to marginally favour one final rate hike. If we are right, there is clearly more room for a GBP-positive outcome, given today's post-CPI drop in the pound.

Francesco Pesole

BRL: BCB to deliver another 50bp rate cut

After the FOMC decision later today, Brazil's central bank (Banco Central do Brasil) is widely expected to deliver another 50bp rate cut. The size of future cuts (50bp) was approved unanimously at the August meeting even if the August 50bp cut itself was not.

The Brazilian interest rate swap strip prices in slightly more than 50bp cuts at each of the three BCB meetings this year (including today's meeting). There could be some mild disappointment here if the BCB sticks firmly to the script of 50bp cuts for the foreseeable future.

Yet strong growth in Brazil (second quarter GDP at 0.9% QoQ versus 0.3% expected), solid demand for the carry trade (BRL three-month NDF implied yields at 11.2%) and highly positive real rates provide a good underpinning for the currency.

Equally, investors are positively minded towards Brazil right now and have pushed its sovereign CDS to the narrowest levels of the year. Assuming no hawkish shocks from the Fed today, carry trade demand should dominate and drive USD/BRL down to the 4.80 area.

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