

FX Daily: Bearish steepening of money market curve lifts the dollar

The dollar is higher after the Fed raised rates 75bp again yesterday. Chair Jerome Powell is trying to switch attention away from the pace of rate hikes to the terminal rate, which he said will likely be higher than what the Fed had estimated in September. Expect the dollar to hold gains - especially versus GBP were the BoE to surprise with just a 50bp hike



USD: Higher rates for longer

As we discussed in yesterday's [Fed reaction piece](#), the dollar initially sold off on the FOMC statement, but then rallied on what was overall a hawkish press conference. When the dust had settled, the US money market curve had bear-steepened - e.g. 1m USD OIS rates priced six months forward were 6bps higher, but priced 12 months forward were 12bps higher. There were many ways to read the press conference, but one interpretation is that Chair Powell was trying to shift the narrative away from how fast the Fed would be hiking towards how high the terminal rate would have to go and how long it would have to stay there. The press conference also concluded with a sense of frustration from Chair Powell that inflation had not fallen more quickly - and he certainly did not provide any encouragement to those in the market looking for an early fall in

rents (a key component of core inflation).

With the focus now switching to the terminal rate, Chair Powell has guided expectations that it will be higher than the 4.50-4.75% area the Fed [had estimated back in September](#). That could prepare us for another bullish dollar event risk with the release of the next set of projections on 14 December - assuming neither employment nor core inflation sags quickly.

Expect Fed policy to prove a bullish undercurrent to the dollar and an even more inverted US yield curve to weigh in particular on the high beta activity and commodity currencies, such as the Australian and New Zealand dollars, Norway's krone and Sweden's krona. Where there could be some joy for those a little more bearish on the dollar is amongst high-yielding Latam FX - especially the Mexican peso. Some have made the good point that the slower pace of Fed hikes could reduce volatility in the interest rate markets. Indeed, the MOVE index - a basket of US Treasury implied volatility across maturity buckets - edged lower yesterday. FX volatility typically takes its cue from the interest rate markets. Lower FX volatility will increase risk-adjusted returns, where we think the 11.1% MXN implied yields available through the three-month forward look attractive and could drive USD/MXN to 19.45/50 during brief periods of calm.

For today's US session, the focus will be as usual on the weekly jobless claims data. We also have ISM services and the September trade balance. The US monthly trade deficit has narrowed in from \$107bn to \$67bn this year, no doubt helped by rising US energy exports. Another dollar positive.

We favour a flat to higher DXY today (perhaps to 112.50) as the market consolidates ahead of tomorrow's monthly US jobs release.

Chris Turner

EUR: Dollar hedging costs are 3% again

The jump in US short-dated rates has widened the two-year differential between EUR and USD swap rates back to 210bp again - not far from the widest levels of the year. Equally, the shorter-dated yields now indicate that it will cost euro-based companies around 3% per annum to hedge the dollar using rolling three-month forwards - that is expensive. EUR/USD is gradually sinking back towards 0.98 and we feel momentum could easily build for a push to 0.9650 tomorrow if US jobs and wage data do not slow as much as expected. In Europe today, there are a lot of European Central Bank speakers, where the doves are trying to get the message across that the forthcoming recession will do some of the work in taking inflation off its highs. EUR/USD could trade in a 0.9760-0.9850 range today.

Chris Turner

The Bank of England (BoE) will not be the only European central bank announcing policy today, as Norway's Norges Bank (NB) is also due to deliver another hike. We note that consensus is split between a 25bp and a 50bp move today: we expect a half point hike, as the September CPI upside surprise (6.9% year-on-year) may have overshadowed concerns about slowing economic activity. We think this can offer some extra help to the krone, which is already benefiting from oil's good performance and the support from Norges Bank's reduced daily FX purchases (from NOK 4.3bn to 3.7bn) for November. EUR/NOK may break below 10.20 in the near term, but we suspect that a worsening of risk sentiment conditions into year-end may limit further NOK appreciation.

Francesco Pesole

📌 GBP: Scope for a 50bp BoE surprise today

My colleague James Smith is making the '[courageous](#)' call that the Bank of England will only hike [50bp today](#). His argument is that the consensus 75bp hike would end up seeing UK CPI undershooting the BoE's 2% target in 2025. In other words, the BoE does not need to increase the pace of tightening right now. As we discuss in that BoE preview, the FX options market attaches a 150 pip GBP/USD range to today's event risk. That could see GBP/USD trading back to the 1.1250 area if we are right with our BoE call. EUR/GBP could trade back to 0.87 too.

Sterling also looks challenged from both: i) the international investment environment where US equities sold off 2.5% yesterday on the prospect of higher for longer Fed rates and ii) what is shaping up to be quite a tight fiscal event in the UK on 17 November as the new government struggles to plug its borrowing gap.

Chris Turner

📌 CEE: No change in Czech National Bank approach

The highlight of this week's calendar is today's Czech National Bank (CNB) meeting. We [expect](#) interest rates to remain unchanged, in line with market expectations. Thus, the key will be the new central bank forecast, which we believe will show lower inflation but also higher wage growth. Also key for the market will be the interest rate forecast, or any indication of the timing of the first rate cut next year and the long-term level. However, the main focus will be on FX intervention, with which the CNB has been defending the koruna since mid-May. However, in our view, the current central bank approach will only be confirmed, and we do not expect any changes.

On the FX market, we see the koruna underperforming the Polish zloty in recent days, which can be attributed to the building of short positions ahead of the CNB meeting. We can expect this trend to continue until the central bank's decision up to 24.60-70 EUR/CZK as a bet on the end of the intervention regime. But after the press conference, we can expect the liquidation of those positions and the return of the koruna to stronger levels. However, we believe that this effect will be smaller compared to the September meeting given the greater clarity that the CNB will not change its intervention regime.

Elsewhere in the region, given the empty calendar, it will be purely about the fallout from yesterday's Fed meeting and as expected, the picture is clearly negative for Central and Eastern European FX. EUR/USD is heading lower while rising core rates are pushing interest rate differentials lower across the region. Thus, we expect the Polish zloty and Hungarian forint to open with losses today.

Frantisek Taborsky

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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