

## FX Daily: Cautious Fed cut shouldn't interfere with strong dollar

We expect the Federal Reserve to deliver a consensus 25bp cut today, but also to scale back on guidance for rate cuts next year. We think this will allow the dollar to stay firm into year-end as wide differentials remain highly favourable for the greenback. UK inflation rose as expected in November, which only changes the BoE's picture slightly



Even if the Fed's communication nuances end up delivering some sort of dovish surprise today, we doubt the central bank will move far from its generally cautious stance on guidance

### ➔ USD: Trump policy pledges to be felt at the FOMC

Our view for today's Fed rate announcement is that the risks are broadly balanced for the dollar, and we see limited scope for a surprise driving major FX moves. The prospect of fiscal stimulus among other promised policies by US President-elect Donald Trump will, in our view, force some scaling back in expected rate cuts included in dot plot projections as rates are cut by 25bp, matching pricing and consensus. More in our [FOMC preview](#) here.

Even if the communication nuances end up delivering some sort of dovish surprise, we doubt the Fed will derail from a generally cautious stance on guidance, which inevitably leads the markets' own (hawkish-implying) expectations for Trump's policy mix as the main driver for rate expectations. This means that any potential USD correction should not have long legs. Also remember that January is a seasonally strong month for the greenback, and markets may be

lured into building strategic bullish USD positions as Trump's mandate kicks off.

Our baseline view for today is that the modest hawkish readjustment in Fed communication will leave markets content with current pricing for further Fed meetings: a hold in January and around 50% implied probability of a March move. Ultimately, that can leave the 2-year USD OIS at the 4.0% mark and DXY close to 107.0 into Christmas.

*Francesco Pesole*

## ➔ EUR: German story to stay soft before turning any better

The latest input to the eurozone's growth story – [another decline in the German Ifo index](#) – should keep market's dovish tendency in European Central Bank pricing well intact, even if consensus is building that the upcoming German election will generate some degree of fiscal support. Ultimately, a retightening in the very wide Atlantic spread seems unlikely in the near term.

EUR/USD has continued to hover around the 1.050 gravity line, and we see a good chance this will remain the case into the end of the month. Still, we are comfortable with retaining a negative bias on the pair into the new year, where the start of Trump's second term in office should offer multiple reasons to stay bearish.

In the UK, CPI data released this morning showed increase from 2.3% to 2.6% year-on-year, with the month-on-month slowdown moving from 0.6% to 0.1%, in line with market consensus. Our core services metric, which strips out all the volatile stuff and also rents/hotels (i.e., elements that the Bank of England is less bothered about) did tick higher from 4.5 to 4.7%. Our view on EUR/GBP remains generally flat for the near term, even if an eventual acceleration in [BoE easing](#) next year can offer some pockets of support.

*Francesco Pesole*

## ⬇️ BRL: Failing to tackle the problem at source

Despite attempts by the local central bank to get 'ahead of the curve' last week with an outsized rate hike, the Brazilian real has remained under heavy pressure. Here, the central bank has been involved in several rounds of dollar selling intervention, including two rounds totalling over \$3bn yesterday. Money markets now price BACEN hiking the 12.25% policy rate above 16% over the next 6-12 months, with the central bank having to do the heavy lifting when it comes to defending the real. Fortunately the central bank has a large stock (\$330bn) of FX reserves, and at this stage there are no concerns of lack of available resources to defend the BRL.

However, the source reason for the ongoing BRL sell-off is the fiscal side. Here the suspicion is that the Lula administration will want to keep fiscal policy loose into 2026 elections and will not be swayed by pressure on Brazilian asset markets. Until the government is prepared to come back with some genuine fiscal consolidation it is hard to see the BRL enjoying much of a rebound.

How far could BRL fall? In our [last edition of FX Talking](#) we had felt there was outside risk to the 6.50 area. These are difficult times for those with Brazilian assets. However, commodity producers with a cost base in the country now see attractive levels in the one-year outright forward above 6.60.

*Chris Turner*

## ➔ CEE: Market switched to Christmas mood

As expected, [the National Bank of Hungary left rates unchanged yesterday](#) and forward guidance did not see much change either. As in November, one member voted for a rate cut. But at the same time, the press conference tried to introduce a long pause in the cutting cycle. The new forecast showed a slightly higher inflation profile for next year, while the economy will be weaker this year compared to the September forecast.

The NBH found a rather muted market reaction to today's meeting. In line with CEE peers, the EUR/HUF moved up very little after the press conference. The HUF market, like its CEE peers, seems to have already switched into Christmas mode, and with little news coming out of today's NBH meeting, it is hard to expect a big market view. EUR/HUF seems to have stabilised around 408-410 for now.

Today's calendar in the region is empty with several bond auctions on the calendar only, the last of the year. The rates market seems to be dominated by low liquidity and CTA flow, which is driving rates up, especially in the PLN market, which could again deliver some boost to FX. On the other hand, CZK rates seem too aggressively hawkish after a few days of upward movement and closed lower yesterday despite the spike in rates, indicating in turn a weaker CZK into the Czech National Bank's meeting tomorrow.

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