

FX Daily: Dodging the pivot

The Fed should hike by 75bp today, but markets appear divided on the degree of openness to slower tightening by Chair Powell. We suspect that lingering data-dependency may put off pivot speculation to the next inflation report, leaving risk assets vulnerable and the dollar bid. In this scenario, we expect the high-beta pound to suffer more than the euro



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USD: Is the Fed really a make-or-break event for the dollar?

It's FOMC day, and the extreme sensitivity of global assets and the dollar to the theme of a dovish pivot has boosted the notion this will be a make-or-break event for market sentiment. With so much at stake, our approach has been to look at different scenarios for markets and the dollar in our [FOMC preview](#). There, we also highlight our baseline scenario, which sees a 75bp hike (consensus view) being accompanied by some tentative openness to a slower pace of tightening.

It does appear that there is a considerable heterogeneity of expectations on the Fed today, which indeed makes it harder than usual to draw a precise market reaction function. Still, it appears that investors have been swinging increasingly in favour of a dovish pivot, which in our view increases the chances of a hawkish surprise. In particular, any reference to a potential slowing of the pace of

hikes may come with some strings attached, retaining a de-facto data dependency and making the next inflation report the real pivotal event for markets. Given the tendency of inflation to surprise on the upside, investors may be reluctant to fully price out a 75bp hike in December (currently, 60bp is embedded in the OIS curve).

So, what does this mean for the dollar? We are inclined to think that Chair Jay Powell will need to drop a substantial chunk of his data-dependent approach, and emphasise the risks of recession over the risks of inflation, in order to drive a substantial dollar downtrend. However, it does seem too early for this, and a risky move given the lack of evidence that inflation is coming under control. With markets still left in limbo, we suspect the balance of risks for the dollar is skewed to the upside today. After all, recent price action has pointed to interest in rebuilding long-dollar positions after the late-October correction, a dynamic that remains supported by a heavily inverted yield curve, instability in the equity market and lack of alternatives to the dollar in FX given macroeconomic uncertainty (especially in Europe and China).

While surely a close call, we see DXY closing the week above the 112.00 handle, and moving back to the 113.00+ highs in the coming weeks.

There are also US ADP jobs figures to keep an eye on today, but the proximity to the FOMC announcement and the limited predictive power on actual payrolls (which are released on Friday) should limit market sensitivity to the release.

Francesco Pesole

📉 EUR: Eyeing 0.9800

It's all about the FOMC announcement today for EUR/USD, and we see downside risks for the pair into the weekend. The 0.9800 level may prove quite pivotal, as this was an important anchor before last week's upside correction. A break below 0.9800 before the end of the week would likely imply markets defaulting to the pre-correction levels, and signal a return to a more structural bearish tone on the pair, which could unlock further downside room.

The main development to follow in the eurozone at the moment is the rhetoric of European Central Bank speakers after the upside surprise in eurozone inflation numbers. Yesterday, Germany's Joachim Nagel and Spain's Pablo Hernández De Cos firmly reiterated that there is still a long way to go in tightening, and we'll hear from Ireland's Gabriel Makhoul and France's François Villeroy today. As discussed on multiple occasions, the euro remains unable to draw substantial benefits from the ECB's hawkish tone.

Francesco Pesole

📉 GBP: More at risk than the euro

The pound bounced back yesterday, as it continued to display the kind of high beta to risk sentiment that would normally be associated with commodity currencies in the G10. This feature inevitably puts the pound at risk of a larger drop than other peers – like the euro – if the Fed fails to offer support to risk assets today.

We continue to highlight the risk of a dovish surprise (50bp hike) by the Bank of England tomorrow: more details in our scenario analysis. The combination of a USD-positive FOMC and a GBP-negative Bank of England means cable could test 1.1300 by the of the week. EUR/GBP may climb back into

the 0.8650-0.8700 area in the coming days.

Francesco Pesole

📉 CEE: Fed as party crasher

For today, we have PMIs in Poland and Hungary on the calendar. As already foreshadowed by the result in the Czech Republic, a negative surprise can be expected here as well. Special attention will be given to Poland, which is currently leading the decline in leading indicators in the region.

Poland and Hungary are returning to the market after the holidays today. Meanwhile, conditions in Central and Eastern Europe are deteriorating and FX is heading into the Fed meeting without much support. The US dollar continues its rally, local rates are lower against core rates across the region and yesterday's jump in gas prices back above EUR100/MWh is not helping the situation either. Thus, we expect to see selling pressure in CEE markets return.

Moreover, in the Czech Republic, we will see the Czech National Bank [meeting](#) on Thursday, which traditionally attracts short positioning with the prospect of an end or change to the central bank's FX intervention regime, which should take the koruna back to CNB intervention levels in the 24.60-24.70 EUR/CZK range. Despite strengthening over the past two days, we continue to think that the Polish zloty and Hungarian forint should trade higher as well. Just based on the current interest rate differential and FX relationship, we see the zloty closer to 4.75 EUR/PLN and the forint closer to 415 EUR/HUF. Moreover, with the Fed meeting today, we expect pressure on the CEE to increase during the day, which may lead to a painful end to the current rally in the region.

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