Article | 13 December 2023

FX Daily: Dollar can get support from well-telegraphed Fed pushback

It is now a very consensus view that the Fed will push back against rate cut expectations. We expect the Dot Plots will show only 50bp of cuts in 2024. Still, markets may feel less comfortable about the first rate cut coming in May, and a softening in risk sentiment could help the dollar today – and into Christmas

USD: Powell can still help the dollar

Part of the move in the dollar and other assets that we would have expected to be triggered by a hawkish hold from the Federal Reserve today has likely already materialised after strong US payrolls and the consensus CPI reading yesterday. Markets have trimmed around 11bp of easing from the 6m section of the Fed funds futures curve, but still fully price in a first cut in May, and we think Chair Jerome Powell and the majority of FOMC members will still consider those expectations as too dovish for their objectives.

As discussed in our Fed preview, the main tool the central bank will have to steer the market is the new set of Dot Plot projections. We estimate that the 2024 plot will be revised lower to 4.9% from 5.1%, meaning 50bp of cuts next year from the current rate. That would be quite a clear pushback against the over 100bp of easing priced in by the end of next year, although the "pushback" narrative is likely well-telegraphed by now and our rates team does not expect a huge impact on the rates market. On the FX side, the balance of risks appears tilted to the upside anyway, as risk sentiment may face a tougher environment and favour a USD strengthening via the safe-haven channel, if rates don't move much. We think that the most recent data flow in the US and a hawkish tone from the Fed today will keep the dollar from another major slide into the Christmas holiday period. Instead, a stabilisation around 104/105 in DXY seems more plausible, in our view.

Incidentally, overnight news from China favours some dollar demand into today's key risk event. At the annual Communist Party conference, the government set industrial policy as a top priority for next year, slightly sidelining the boost to domestic demand that some investors were counting on to stimulate the struggling Chinese economy. That confirms our expectations that China-related sentiment will not recover rapidly and that risks persist.

Today, PPI figures out of the US will be watched closely too, although the FX impact could be limited due to the proximity to the FOMC announcement.

Francesco Pesole

EUR: Fed can favour reconnection with rate differentials

This will be another day where EUR/USD is entirely driven by the USD leg, with the eurozone calendar only including the non-market-moving industrial production numbers. We see downside risks for the pair this week despite our view that the European Central Bank will follow the Fed with a rate cut pushback of its own.

The main reason for this is that this "coordinated" hawkish recalibration by central bankers before Christmas could cause a softening of the risk environment, the resilience of which has allowed EUR/USD to stay around current levels despite the EUR-USD short-term swap rate differentials being at the lowest of the year (around 130-135bp). A hawkish hold by both the ECB and the Fed may not move the rate differential much, and the spread would have to retighten significantly anyway to technically justify a sustainable rally in EUR/USD. We think EUR/USD bulls should be happy with the pair finding support at 1.0700 before Christmas.

Francesco Pesole

GBP: Soft GDP figures not key for the BoE

UK monthly GDP for October came in weaker than expected at -0.3% month-on-month, which was mostly due to a decline in manufacturing activity: the production sector has been unusually volatile this summer.

The October figures mean that we are on track for a marginally negative 4Q GDP print in the UK, although that is not at the top of the Bank of England's concerns at the moment. We still expect a hawkish tone tomorrow to give some help to sterling, especially in the crosses. Today, GBP/USD may well break below the 1.2500 gravity level.

Francesco Pesole

SEK: Declining inflation expectations point to end of tightening cycle

The Prospera surveys – which are highly regarded by the Riksbank – showed that long-term (five-year) CPIF inflation expectations in Sweden remained unchanged at 2.1%, while two-year inflation expectations eased from 2.6% to 2.2%. The Riksbank will probably look with favour at this latest figure.

Interestingly, the survey also shows that interviewees see the benchmark rate being cut by 50bp in the next year, much less than the over 100bp priced in. Also, there are no expectations for another hike in February, despite the Riksbank still keeping it as a possibility in its latest projections. We agree that another hike looks unlikely, and given that FX hedging operations - which have contributed a lot to SEK's relative outperformance recently - will end by mid-February in our estimates, we think that the krona will start underperforming its peers like Norway's krone from early next year.

Francesco Pesole

Authors

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com