FX Daily: Dollar sprints to the finish line

The Fed delivered a hawkish cut yesterday, signalling only 50bp of easing in 2025 and shifting to a more patient tone on easing. That has led to another dollar rally, which we see extending into the new year. A hesitant BoJ has added fuel to the USD/JPY bull run. Today, the macro year will be wrapped up with rate decisions in the UK, Sweden, Norway and Czechia

The is the last FX Daily of the year. We will resume publishing on Friday 3 January.

USD: Hawkish Fed sends USD spiking

The Federal Reserve cut rates by 25bp as expected yesterday, but the broader policy message was more hawkish than expected. The new dot plot projections were heavily revised, now only factoring in 50bp of additional easing in 2025, and one FOMC member voted for a hold. Fed Chair Jerome Powell said that the Fed will be more cautious moving on and that more progress on inflation is needed for further cuts. Remember, the dovish shift by the Fed a few months ago was triggered by concerns about the jobs market. Yesterday, Powell said the risks to the labour market had diminished, effectively removing any sense of urgency when it comes to easing.

The bear flattening in the US curve pushed the dollar to new highs. DXY is trading at 108.0 and as we discussed in our FOMC review, we think this hawkish re-tuning of the Fed's communication will lay the foundation for sustained dollar strengthening into the new year. Markets are fully expecting a hold in January and 11bp are priced in for March. If indeed the dot plot works as a benchmark for rate expectations for the next three months, the bar for a data surprise to seriously threaten the dollar's big rate advantage is set higher.

The Bank of Japan also announced policy, delivering a rather cautious hold which has been digested as a dovish surprise by markets. Consensus was indeed for a hold today but probably expecting more openness towards a hike in January. Governor Kazuo Ueda sounded more data-dependent than forward-guidance-orientated, saying additional information on wages and growth is needed.

USD/JPY has surged through 155 on the back of the hawkish Fed and a hesitant BoJ. The direction of travel looks clearly towards the 158/160 area – an area where the BoJ has sold close to $100bn this year in previously successful attempts to stabilise the yen. We presume the incoming US Treasury will not mind this intervention given that Japan will be trying to support its currency. And back in 2019, the US Treasury labelled China a currency manipulator for allowing its currency to weaken.

Francesco Pesole

EUR: Focus on Scandinavian central banks this morning

EUR/USD took another hit after the Fed. As discussed above we expect the shift in language by Powell to favour a longer period of dollar dominance and keep the Atlantic Spread wide. All this reinforces our view that EUR/USD will keep sliding lower in the coming weeks, and we expect to see the 1.02-1.03 levels being tested.

Elsewhere in Europe, we'll see central bank announcements in Sweden and Norway this morning. We expect a 25bp cut by the Riksbank and a hold by Norges Bank.

As discussed in our Riksbank preview, forward-looking activity indicators are starting to paint a more optimistic picture in Sweden and inflation has come in hotter than expected of late. However, growth was soft in October. While the end of the easing cycle is in sight (we think rates will bottom at 2%), another cut today seems plausible given the Riksbank's greater focus on growth and still dovish communication. Anyway, that is a consensus view and we don't expect major deviations from 11.50 in EUR/SEK near term.

In neighbouring Norway, concerns about an excessively weak NOK have somewhat eased, but EUR/NOK close to 11.80 is still unwelcome by Norges Bank. A re-acceleration to 3.0% in core CPI in November should allow NB to keep supporting the currency via an unchanged policy rate for a bit longer. We still think a cut can come in 1Q25, but that may start to be a closer and closer call. EUR/NOK continues to have good downside potential on fundamentals, but the patchy external environment ahead of Trump's inauguration should keep NOK bulls satisfied with some stability at best.

Francesco Pesole

GBP: A non-event by the BoE

The latest macro indicators have all but reinforced expectations that the Bank of England will keep rates on hold today. The focus will be on any tweaks to forward-looking language and the vote split (which we expect at 8-1 hold-cut). There is no press conference scheduled for this meeting.

Our perception is that the BoE will try to make this announcement a non-event, offering cautious signals for further easing down the road but still highlighting stickiness in services inflation and wages.

Ultimately, we don't see the pound being hugely impacted today, and the near-term outlook remains positive for the currency – at least until a fresh round of UK data potentially throws the latest hawkish repricing into question. We see EUR/GBP staying capped below 0.8300 in the coming weeks.

Francesco Pesole

CZK: CNB pause in the cutting cycle

The Czech National Bank is very likely to take the first pause in the cutting cycle today and leave rates unchanged at 4.00%. The main reason is likely rising headline inflation, which is expected to exceed 3% in December although core inflation remains close to the central bank's 2% target. The December meeting will only offer an update to the November forecast. Thus, the main focus will be the press conference and the question of the February meeting. Our economists believe the pause will continue through February and only the March meeting is live for another rate cut. However, January inflation is expected to return to below 3% and risks have been pointing down in recent weeks. Therefore, we believe the February meeting is live and so today we will be looking to see how likely that is.

The market has gone too far with hawkish pricing with roughly one rate cut by the May meeting next year in our view. We think interviews have shown a still CNB board in a cutting mode. Therefore, we believe the communication today will focus on the February forecast and the January inflation print. At the same time, the vote split in our view adds dovish risk for today with 7-0 as a baseline but a decent chance of seeing one or two votes for a rate cut as well. Overall, we prefer to be on the dovish side given market pricing in rates and expect weaker FX after the meeting today.

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