

## FX Daily: Dollar to stay supported as Fed shifts to the exit

It is a big day for global financial markets. The FOMC statement and new economic projections will be released at 2000CET tonight, followed by a press conference from Chair Jay Powell at 2030CET. We expect the Fed to signal a faster pace of tapering and show more concern over the path of inflation. This favours continued dollar strength against the EUR and JPY



Fed Chair, Jerome Powell

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### USD: Dot Plots have been a key driver of the dollar

Trade-weighted measures of the dollar, such as the DXY, have rallied around 7% this year. The bulk of those gains came in the second half of the year and in our opinion have been driven by the sea change in expectations for Fed policy. Having pitched a story that rates would be left unchanged until 2024 such that inflation could catch-up for prior undershoots, the June and then the September Dot Plots told us that the Fed was shifting to a more conventional tightening cycle.

That is why today's communication from the Fed will be so important for the dollar. New Dot Plots that show a Fed median expectation of two hikes in 2022 will very much support the notion of the

Fed moving into tightening mode (we haven't said that for a while) and there will be plenty of interest as to how the Fed now refers to inflation - after Powell said its description as transitory should be 'retired.' Please read our team's full Fed preview [here](#).

While short-term USD money markets seem to have quite a lot priced in for the next 12 months (nearly three 25bp hikes priced), the Fed cycle is still conservatively priced around the 1.35/40% area over the next two to three years. We think this pricing can shift closer to the 1.80% area - in line with the Fed Dots - and that should continue to be supportive for the dollar against the low yielders such as the euro and the yen. It is probably a consensus view now, but three weeks of consolidation should have been enough for the dollar to correct overbought technical conditions and today's Fed meeting should be the catalyst for an upside breakout.

Ahead of the Fed, we have seen the news that Congress has agreed to raise the debt ceiling. And we should see a good US November retail sales release as well.

We think DXY could be ending today's US session above 97. USD/JPY could certainly come back into play too given that our debt strategy team favours a steeper US yield curve in 1Q22 with longer-dated US Treasury yields pushing ahead. Expect 115 in USD/JPY to be pressed again.

## ↓ EUR: At the mercy of the dollar

EUR/USD will be driven by the Fed story today. However, leaked reports suggest that the new European Central Bank CPI forecasts to be released tomorrow will show inflation dropping back under 2% in 2023 and 2024 - giving the ECB plenty of room to keep all its options open. That should be the [core story](#) of tomorrow's ECB meeting and offer the EUR little protection against a stronger dollar. If tonight's Fed is as hawkish as we expect, EUR/USD should press the 1.1170/80 area later today, with a close below opening the door to 1.10.

Offering more resistance to the strong dollar will be the Czech crown. Money markets are pricing the Czech policy rate at 4%, yes 4%, next summer - pricing that the ever-hawkish Czech National Bank (CNB) governor, Jiri Rusnok, supported yesterday. While CEE currencies typically do not fare well in a strong dollar environment, at 4% the CZK will truly be a European high-yielder - especially backed by a strong sovereign balance sheet and a 5-year sovereign CDS trading at just 40bp. 25.00 beckons for EUR/CZK. Look out for the next CNB meeting on 22 December, where another large rate hike cannot be ruled out.

## ↑ GBP: Gas and CPI will keep BoE in play

We have just seen UK November CPI released at 5.1% YoY. We had not thought that CPI would peak until April (at 5%). That trajectory clearly needs to be revised higher now. European gas prices have this week broken to new highs as well - which will give the Bank of England a real headache over whether to hike or not. Given the BoE has positioned itself as ready to move policy (unlike the ECB for example), we suspect a higher price environment can keep GBP money rates and the pound supported.

We favour EUR/GBP breaking back down to the 0.8450 area, while cable could put up some strong support against the firm dollar at 1.3170/3200.



## CHF: What can the SNB do tomorrow?

The Swiss National Bank meets tomorrow and it is not clear what it can do to turn the strong Swiss franc around. Yes, the nominal trade-weighted Swiss franc is at its all-time highs, but courtesy of very low inflation in Switzerland, the real trade-weighted Swiss franc is still 3-4% off the highs seen in January 2015. Yet we should still expect the SNB to describe the Swiss franc as 'highly valued' and threaten FX intervention - even though that has been slowing this year.

We could also see a technical move where the SNB increases the amount of CHF sight deposits not subject to the -0.75% negative rate. This would be a move to help the net interest margins of the local banking system and could be read as the SNB wanting to take rates even deeper into negative territory - though such a move seems unlikely.

EUR/CHF should remain fragile and we probably need to wait for a more hawkish shift from the ECB before EUR/CHF finds a firmer foothold.

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