

FX Daily: Fed brings tidings of comfort and joy

In a somewhat surprising move, the Fed has acknowledged recent disinflation trends and poured gasoline on the fire of easing expectations for 2024. The news has understandably been greeted by global asset markets, where stagflationary bets are being replaced by reflationary ones. This is broadly dollar negative. Look out for the ECB, BoE and SNB today



📉 USD: Fed softens stance earlier than we thought

Last night's FOMC release, dot plots and press conference surprised us and the markets. Instead of the Federal Reserve pushing back against the 100-125bp of rate cuts priced by the market for 2024, the overall message was a softer one. In effect, it welcomed disinflation trends and fed into the narrative that if inflation is under control, why does the US economy need very restrictive monetary policy in the form of a real policy rate above 2%?

Asset markets responded very well to the prospect of the Fed releasing the handbrake on the US and global economy, with both bond and equity markets rallying broadly. For us in FX, we had not expected it this early but last night's dovish Fed shift triggered a massive bull steepening in the US

curve – a move that is the centre piece of our call for a broadly lower dollar next year. US two-year Treasury yields fell 30bp and the 2-10 year Treasury curve bull-steepened by 12bp. As discussed in our 2024 FX Outlook, we think this shift towards a more reflationary policy setting stands to see outperformance of the undervalued commodity currencies, and again, overnight the under-valued Australian and New Zealand dollars led the pack. We are also pleased to see EUR/AUD 3% lower over the last month, a move we highlighted in our outlook.

Looking ahead, the focus switches to four rate meetings in Europe and to what degree the likes of the European Central Bank or the Bank of England do a better job than the Fed in pushing back against easing expectations for next year. If indeed they do a better job, it will only add to rallies in EUR/USD and GBP/USD. And the Fed's dovish turn last night continues to trigger an unwind in yen short positions as USD/JPY falls further. Next Tuesday's Bank of Japan policy meeting is eagerly awaited. Even though we do not look for any material adjustment in BoJ policy next week, USD/JPY may still well drop to 140 beforehand.

Away from policy rate meetings in Europe, today sees US November retail sales and the weekly initial claims. Given the market firmly has the easing bit between the teeth, any signs of weakness in this data could trigger another leg lower in the dollar.

DXY has support at 102.50/65 below which the 100.80/101.00 area looms large.

Chris Turner

EUR: Gauging the ECB pushback

Attention turns to the ECB today. Investors are currently pricing in over 125bp of rate cuts next year, with the first full cut priced for the April meeting. We think that is far too early. However, the question today is how far ECB President Christine Lagarde wants to push back against that. Feeding into the story will be revisions to ECB staff growth and inflation forecasts. The larger the downward revisions to both growth and inflation (e.g. if the 2025 CPI forecast gets cut below 2%), the more euro money market rates will soften, and the euro will lag other currencies as they advance against the softer dollar.

Our ECB market preview felt there were upside risks to EUR/USD going into this ECB meeting. EUR/USD has already enjoyed a strong rally on the back of the softer US rate view, and assuming the ECB does not fully embrace dovish expectations for next year, we would say the bias for EUR/USD lies towards 1.0945/65 and probably 1.10 multi-day. Over recent months, we have been forecasting EUR/USD to end the year somewhere near 1.07. After last night's Fed shift, we expect EUR/USD ends the year closer to 1.10 now.

Also, today look out for the Norges Bank and Swiss National Bank meetings. Presumably, the SNB will cut its inflation forecasts. Having consistently sold FX since last year – delivering nominal Swiss franc appreciation and keeping the real Swiss franc stable – we are interested to hear today whether the SNB has been both buying and selling FX. If it confirms it is on both sides of EUR/CHF, rather than just being a EUR/CHF selle, and we suspect EUR/CHF can jump back up to the 0.9550 area.

Chris Turner

➔ GBP: Focus on the BoE vote

A keen focus for today's Bank of England meeting will be the vote split. Back in November, there were still three hawks voting for a 25bp hike. The degree to which the vote split softens from 6-3 will impact sterling today. Also in focus will be the BoE's forward guidance and whether it softens its view that policy needs to stay restrictive for an 'extended period'. Shifting this guidance to 'for quite some time' or more dovishly to 'some time' could hit sterling and see UK money markets play catch up with some of the aggressive easing priced into the US and particularly the eurozone money market curves.

We probably see upside risks to EUR/GBP today, i.e., to 0.8655 or even 0.8685, while GBP/USD should be more supported against the softer dollar. GBP/USD to perhaps trade to the strong side of a 1.2625-1.2685 range.

Chris Turner

⬆️ MXN: Will Banxico turn dovish too?

Quite understandably, the rest of the Latam FX complex did not have to sell off with the 50% Argentine peso maxi-devaluation yesterday. The prior official rate of ARS345/USD was the wrong rate and effectively provided a subsidy to the export sector. ARS800/1000 seems to be a fairer rate and we will be interested to hear what final conversion rate could be used under the ultimate de-dollarisation plan.

Turning to the rest of Latam, Brazil's central bank cut 50bp as expected yesterday. The focus shifts to Banxico today. There has been some suggestion that it wants to fine-tune its 11.25% policy rate with a small cut early next year, perhaps in March. The unique problem for Banxico is that Mexico's government is loosening up fiscal policy into a 2024 election year, which should see the economy growing by a decent 2%. It is uncertain, therefore, whether it will offer concrete signs of easing at today's meeting.

Most roads, however, we believe lead to a stable to stronger peso. The macro story looks good – including record remittances running at \$5.8bn per month – but the main risk is that Banxico tries to reign in peso strength by offering easier policy after all. This should be a positive cocktail for non-FX hedged positions in the short end of the government MBONO bond market. And USD/MXN does not stray too far from 17.00.

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