

FX Daily: Hawkish 75bp Fed hike can keep dollar bid

We expect a 75bp rate hike by the Fed today, accompanied by a hawkish tone and Dot Plot projections which may show a terminal rate around 4.25-4.50%. We think this could keep risk sentiment fragile and offer further support to the dollar. Elsewhere, SEK is struggling to benefit from yesterday's 1% hike by Riksbank, and UK policy plans remain in focus for GBP



Source: Shutterstock

USD: Fed can keep offering support

The dollar has retained good momentum so far this week, largely benefiting from safe-haven demand as risk sentiment has remained quite fragile. The performance across G10 currencies continues to follow a textbook reaction to an inverted US yield curve (the 2Y10Y currently oscillating around -40/-45bp), with pro-cyclical commodity currencies getting hit particularly hard.

Yesterday, markets had a chance to look at the last bits of data before today's FOMC announcement, with a specific focus on housing figures. Housing starts surprisingly spiked in August, while building permits dropped. On the one hand, this continues to raise concerns around

this sector, as the rise in housing starts points to more supply at a time when high mortgage rates are set to curb demand. On the other hand, falling building permits suggest this may be the last big wave of construction and supply should ease next year.

In terms of today's big event, the FOMC announcement, concerns about the housing market will likely play a marginal role. The above-consensus inflation reading in August and recent Fed communication have left little doubt among investors and economists that the Fed will hike by another 75bp today. This is also our call, as discussed in [our Fed preview](#), where we also explore different scenarios and potential market implications.

With somewhat limited scope for a surprise on the size of the rate hike today, all eyes will be on the updated projections, and especially on the Dot Plot estimates. We expect another revision higher in the median Dot Plot so that the terminal rate should now fall in the 4.25-4.50% area in 2023. Revisions to other economic forecasts should show some signs of a worsening economic outlook, but the notion of broad resilience in the US economy should remain the baseline scenario.

Looking at FX implications, we think that a hawkish hike today by the Fed will keep front-end rates supported and a very inverted yield curve should continue to endorse the dollar's good momentum for now, largely to the detriment of pro-cyclical currencies. With the relationship between short-term rate dynamics and most G10 pairs having waned lately, expect a big chunk of the market reaction to be driven by the reaction in global equities – here a still hawkish Fed may not be read as good news, and that is another reason why we expect the safe-haven dollar to remain bid.

Francesco Pesole

📌 EUR: Empty calendar, all eyes on the Fed

With such a large risk event on the calendar, it's hard to see EUR/USD being driven by anything else than the Fed today. This is especially true considering the lack of market-moving data releases in the eurozone today and only one scheduled ECB speaker: Luis de Guindos, this morning.

What is sure is that the overall environment for the euro remains quite challenging, and the latest reports that Germany is going ahead with a full nationalisation of Uniper - the largest buyer of Russian gas – are working against any relief rally in European sentiment at the moment.

We think the early-September 0.9900 lows can be tested in EUR/USD after the Fed announcement, and a break below that level may unlock further downside for the pair into the 0.9800 support.

Francesco Pesole

📌 GBP: Truss tax cut proposals in focus

While some wait-and-see approach would normally prevail in GBP crosses ahead of tomorrow's big Bank of England announcement, the FOMC and incoming news on domestic policy proposals mean that the pound may remain volatile today. In line with our view for a positive response by the dollar to the Fed announcement, we think cable could set new lows today (a move below 1.1300 possible), and the pound's higher sensitivity to a potentially adverse reaction in equities compared to the euro suggests some upside risk for EUR/GBP (which could re-approach 0.8800).

Prime Minister Liz Truss's policy plans remain very much in focus too, and recent reports that her

government may push for tax cuts – including the stamp duty on home purchases – may ease some concerns about the clouded UK economic outlook, but also fuel doubts about the sustainability of expansionary fiscal policy while delivering a mammoth energy bill support package.

Francesco Pesole

📌 SEK: A tough lesson for the Riksbank

Yesterday, the Riksbank surprised on the hawkish side as it hiked by 100bp (expectations were for a 75bp increase). We discuss the move and market implications in [our Riksbank review note](#).

One important point from an FX standpoint is that the Riksbank might have chosen a larger hike not only because of high inflation and because it has fewer meetings than other central banks (which in theory encourages front-loading), but this may also be read as an attempt to lift the battered krona and offset the increased sales of domestic currency for FX reserve build-up purposes. We are not surprised this attempt has blatantly failed. As discussed in a [recent note on SEK](#), the correlation between monetary policy dynamics and EUR/SEK has faded of late and markets clearly retain a bearish bias on European high-beta currencies in the current environment.

EUR/SEK broke the 2022 highs yesterday, with the next key resistance found in the 2020 Covid crash peaks (all above 11.00). We do admit that SEK has quite a lot of negatives in the price at the moment, and a move above 11.00 in EUR/SEK is still not our base case at this stage, but we acknowledge downside risks have mounted for the krona due to the challenging economic and market conditions, and there is not much the Riksbank's monetary policy can do to help in the near term. If anything, a U-turn (which was however ruled out by Governor Stefan Ingves yesterday) on FX purchases would likely ease some pressure on SEK.

A return below 10.50 in EUR/SEK in early 2023 is still possible in our view, as the krona should be at the forefront of any recovery in global and European risk sentiment. But the timing and likelihood of such a scenario are surely uncertain for the time being.

Francesco Pesole

Author

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

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.