

## FX Daily: Soft dollar once the dust settles

The Fed's surprise 50bp cut and Powell's relatively hawkish remarks sent the FX market on a rollercoaster. It appears that the dollar is softening again this morning, and as we see markets preferring to err on the dovish side of the USD curve, we expect a soft greenback into the election. Elsewhere, the BoE and Norges Bank should keep rates on hold today



Norges Bank will likely keep rates on hold at 4.50% this morning

### ⬇️ USD: Dollar looking vulnerable after outsized cut

The Fed cut rates by 50bp yesterday, which came more as a surprise to economists' consensus than for markets, which had priced around a 65% probability of a half-point move. As discussed in our [Fed review note](#), there was a substantial revision in the Dot Plot projections too. The median Dot Plot is now signalling an extra 50bp of cuts this year, followed by 100bp next year, and 50bp in 2026, with a terminal rate projected at 3.0%.

The initial reaction in the FX market was markedly negative for the dollar across the board, with the yen, Norwegian krone and New Zealand dollar rallying around 1% and the Canadian dollar unsurprisingly lagging other G10 currencies. By the time Powell's conference had ended, those moves had been entirely unwound. The trigger was Powell's attempt to limit dovish bets by saying that 50bp steps won't necessarily be the way forward. We also believe some positioning

readjustment played a role (the dollar is a net short in the speculative community). We have continued to observe higher FX volatility in the Asian session. After a brief overnight USD rally, we are largely back to pre-announcement levels in G10, with only JPY standing out as moderately weaker and the AUD moderately stronger following robust Australian jobs figures.

Where does the Fed's decision leave the dollar? In our view, still in a softer position compared to most developed market peers. Powell tried to mitigate the dovishness of the outsized rate cut, but that it would be hard to fight the perception that it was the dovish market pricing that pushed the Fed over the line for the 50bp move. If the Fed is perceived as unwilling to disappoint market expectations, investors may continue to prefer erring on the dovish side. The USD OIS curve includes 68bp of easing over the last two meetings of the year: a moderate slowdown in the jobs market – not a major upset – is probably enough to cement hopes for 75bp of easing. Ultimately, we see more room for markets to build speculative dollar shorts into the US election, especially considering the USD-negative candidate (Kamala Harris) continues to fare quite well in post-debate polls.

*Francesco Pesole*

## EUR: Room to rise on rate differentials

We remain confident about our 1.12 short-term call for EUR/USD. Once the post-FOMC volatility settles, the short-term rates picture continues to argue for a consolidation in the pair above 1.11, with some upside potential. That was not just reinforced by the Fed's larger-than-expected cut, but also by an increasingly vocal ECB hawkish front, which is preventing markets from pricing in another cut in the eurozone in October.

The EUR:USD 2-year swap spread has continued to shrink, now at -0.85bp. By comparison, that was -160bp in April, and -100bp a month ago. If it wasn't for the eurozone's soft growth picture, we would probably be trading closer to 1.13 now, based purely on rate differentials.

Today, the eurozone calendar doesn't include any market-moving data, but quite a few ECB speakers. We will hear from one of the doves, Panetta, but also from the hawks Knot and Schnabel. Ultimately, the louder hawks should keep markets reluctant to price in more ECB easing, despite the Fed's dovish influence.

*Francesco Pesole*

## GBP: BoE to stay cautious

The Bank of England announces policy today, and we are fully aligned with the consensus and market pricing in expecting no rate cut. As discussed in our Bank of England [preview](#), and in our post-UK CPI [note](#), the inflation picture simply hasn't improved enough to warrant more easing just yet.

The notion that the BoE is threading more carefully than the Fed, and in general not giving away much in terms of guidance, is contributing to gilt underperformance and ultimately GBP strength. That shouldn't change after today's meeting. Some focus will be on the plans for quantitative tightening, which will be announced today. The consensus is probably for the pace of balance sheet reduction to be kept the same (£100bn over the next year).

We think GBP/USD can end the week higher on the back of the Fed-BoE divergence, attempting

another break above 1.33. EUR/GBP could slip back below 0.8400 after the BoE, but we remain more reluctant to a sustainable outperformance of the pound over the euro beyond the near term.

*Francesco Pesole*

## ➔ NOK: Norges Bank to inch closer to cuts

Norges Bank will likely keep rates on hold at 4.50% this morning (0900 BST), but there is mounting pressure to start easing policy soon given the increasingly dovish global backdrop. At the same time, Norges Bank remains quite concerned about the Norwegian krone's weakness. The Bank's own NOK trade-weighted index is around 3.5% weaker than the mid-June highs, and we saw three instances of sharp NOK sell-offs this summer that were not justified by a deterioration in fundamentals.

As per our [latest note on Norges Bank and NOK](#), there is a sense that the Bank is probably using its last hawkish "ammunitions" to support the krone. Yesterday's 50bp cut adds even more dovish pressure to a central bank that is highly sensitive to global rates, and the decline in oil prices is also pointing to lowering the policy rate soon. As Norges Bank publishes new rate projections this morning, we think it will include one 25bp rate cut by year-end, which is fully priced in.

That would still place them in a relatively hawkish position compared to other developed market central banks, which can offer some support to NOK along the way, but today's impact on the krone may be slightly negative. We could see EUR/NOK trade back above 11.80, although fundamentals continue to point firmly at a depreciation in the pair.

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