

FX Daily: The Fed's Big Reveal

In what will be a very busy day of central bank meetings, one central theme will be what the market thinks about the Fed's Big Reveal that it could take the policy rate close to 1.8% in 2024 - way above anything priced into the money market curve. We think that will keep the dollar supported on dips. And look for Norges Bank to start tightening today.



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USD: The market does not seem to believe the Fed

As we wrote in our [initial reaction](#) to the FOMC release last night, the dollar's initial decline on the FOMC statement and economic projections seemed at odds with the hawkish tilt - particularly in the Dot Plots. The dollar only seemed to go bid when Chair Powell said that tapering could be concluded next summer - lending support to James Knightley's view that the first Fed hike could be seen as early as September 2022.

We are a little surprised that the dollar has not pushed further ahead overnight, although this could be down to two factors. The first is that investors do not seem to agree with the Dot Plots that foresee the policy rate being taken to a median of 1.8% in 2024. We were looking at the 1m OIS priced three years' forward last night and after initially rising 4-5bps on the hawkish Dot Plots, it has since slumped to be lower day-on-day. Clearly, the market needs more persuading that rates can get that high and the flattening in the 2-10 year US Treasury curve does give a hint of a

Fed policy mistake. Were such a mistake to occur, this would probably be very bullish for \$/EM - but that is a story for 2022.

The second factor taking the steam out of the dollar rally may be some progress on the Evergrande story, where a press release said that a CNY bond had been restructured - prompting a 5 cent rally in its USD bond. The focus today will be what Evergrande will do about a \$83.5mn interest payment on a USD bond. News about restructuring would be welcomed by the market, whereas a missed payment could darken the mood again.

On balance we suspect the dollar remains bid on dips against low-yielding Europe in particular. Better performing should be the commodity complex backed by central bank tightening. Brazil hiked 100bp last night to 6.25% and promised another 100bp. The high-yielding RUB (6.60% 3m implied yields) should stay bid and today we should see Norges Bank starting its tightening cycle (please see below). More vulnerable could be the South African Rand, where the SARB seems yet to be convinced that it needs to hike rates.

DXY remains near the top of this year's range at 93.50/70, but barring an Evergrande default or some terrible September PMIs out of Europe, those resistance levels may stay intact today.

➔ EUR: Look out for September PMIs, plus Norges and SNB meetings.

EUR/USD has again found support under 1.1700 and large option expiries (EUR3.9bn at 1.1700) may keep it trading a tight range into the 1600 CET expiry. Fresh inputs to the Euro story will come from the flash PMIs for September. The services industry has been recovering well, but the question will be whether manufacturing confidence takes another large step lower in response to China, on-going supply chain disruption and most recently the surge in gas prices.

Tonight also sees the last big TV debate before [Sunday's German election](#). It certainly is hard to pinpoint any impact on the EUR from German election polls, especially with the combination of any coalition far from certain. But further progress of the SPD could be mildly EUR supportive on the back of a looser fiscal agenda.

A [busy week for central bank meetings](#) hits its zenith today with rate meetings in Norway, Switzerland, UK (see below) and four large EM economies.

For Norway, the Norges Bank is set to start its tightening cycle today by delivering the 25bp rate hike that was pre-announced at the August meeting. The move is fully in the price, and the market reaction should be mostly moved by the updated rate-path projections. Our view is that the projections will show another hike this year (which could be pre-announced in November and delivered in December) and three more in 2022. We think could be enough to offer some moderate support to NOK, and a break below 10.1000 in EUR/NOK could see the pair finding more downside momentum. There is also a non-negligible risk that the Norges Bank will add one more 2022 hike in their projections: this should result in an even more decisive drop in EUR/NOK, which could approach the 10.0000 support.

For Switzerland, expect the SNB to position itself as one of the most dovish central banks in the world. To be fair, Switzerland is not facing the same type of inflation pressures as others and the SNB will feel in no hurry to alter its policy of negative rates, continued FX intervention and a description that the CHF is highly valued. EUR/CHF had been showing some strength recently until

the Evergrande situation deteriorated. Any positive news there could see EUR/CHF trade back above 1.09.

↓ GBP: BoE may disappoint market expectations

EUR/GBP has been marking out a well-defined 0.8500-0.8610 range over recent weeks and the risk is that the topside gets tested today. As James Smith and Antoine Bouvet write in their [preview of today's BoE meeting](#), the BoE may not deliver on market expectations of a first hike next April and 40bp of tightening for 2022. At the heart of the story is the BoE needing to see wage growth and second-round effects, rather than merely responding to the jump in headline inflation.

Indeed, the UK economy faces headwinds this Autumn as the furlough scheme comes to an end, benefits are cut and taxes are set to be raised to fund social care. Failure of the BoE today to support those early tightening fears could see 0.8615 tested. Equally, Cable is not far from big support at 1.3570/3600 and with the Fed story providing a supportive dollar back-drop, Cable's downside looks vulnerable.

→ TRY: Central Bank of Turkey shifts focus to core

Turkey's CBT meets today to set interest rates. In focus will be the CBT's statement and what it does with the phrase 'the policy rate will continue to be determined at a level above inflation to maintain a strong disinflationary effect'.

The key here will be whether the CBT alters the statement such that the policy rate (one-week repo rate now at 19.00%) is kept above 'core inflation' rather than 'inflation'. The issue here is that headline inflation was 19.3% YoY in August, while core was at 16.8%. The market fears that a switch to targeting the lower core inflation lays the path for earlier than expected rate cuts – which would be taken badly by Turkish markets.

The focus on a shift to core has been brought to the markets' attention by a speech from the CBT Governor on September 8th. Since then the TRY has under-performed its high-yield peers (e.g. BRL & RUB). Our preferred view is that the CBT will have enough reason to start cutting rates by November or December this year when headline inflation will have dropped to 17% and core to 14%.

We are inclined to think that TRY does not get hit too hard on a credible shift to core inflation targeting (that story already being in the price) although USD/TRY may struggle to hold levels below the 8.50 area.

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