

FX Daily: Three more 50bp hikes today

After the FOMC failed to rock the FX market, we expect 50bp increases by the ECB, Bank of England and the Swiss National Bank today. Among those, the ECB is the one with the higher chance of surprising with a larger hike, and potential hawkish surprises might also come from QT discussions. However, we may not be left with a very different FX picture after today



➔ USD: Fed halts dollar downtrend

The Federal Reserve delivered a [hawkish 50bp rate hike](#) yesterday, signalling rates will be increased and kept at 5.00-5.25% in 2023 via its dot plot projections and verbally pushing back against speculation that inflation is on a sustainable downward path just yet. All in all, the market reaction has been quite contained and was likely capped by Chair Jerome Powell's reluctance to explicitly protest easing financial conditions during the press conference.

The net result in the FX market was that the dollar halted its downtrend, but failed to rebound sharply. The modest bearish flattening of the US yield curve after the announcement should now create a less unfavourable environment for the dollar, and we do see room for some support coming the greenback's way. Incidentally, Fed fund futures show markets are still under-pricing the peak rate (4.87%) compared to the latest dot plot (5.1%). The re-anchoring of rate

expectations with the dot plot will require some help from the data (CPI and nonfarm payrolls above all), but the current divergence would also suggest limited room for another drop in front-end US yields, which was a key threat to the dollar heading into the FOMC.

There are – however – the usual short-term risks to consider. Thin liquidity and seasonal trends may argue against a sustained dollar rebound at this stage, and we cannot exclude a hawkish surprise by the European Central Bank today. A stabilisation in DXY around 103.50-104.00 in the next two sessions may be a signal the Fed has indeed curbed the dollar's bearish momentum, and may allow a recovery to 105+ into Christmas.

Today, central bank meetings in Europe will drive a good deal of market moves, but there are some data releases to watch in the US: December Empire Manufacturing, November retail sales and Philadelphia Fed Business Outlook.

Francesco Pesole

➔ EUR: Not our base case, but ECB may surprise on hawkish side

EUR/USD is trading at pre-FOMC levels (1.0650) after an initial negative reaction to the Fed announcement, which was quite rapidly inverted during Powell's press conference. Today, the focus will shift to the ECB, which unusually announces policy after the Fed this month. [Here is our full market preview of today's meeting.](#)

The chances of a 75bp move have admittedly risen lately, but we expect to see another 50bp hike, possibly accompanied by an announcement that the reinvestment phase of the Asset Purchase Programme will be phased out next year and implicit hints that balance sheet reduction may start in the first quarter of 2023. To us, this looks like the most viable way to bridge diverging views within the governing council.

Markets are currently pricing in 54bp of tightening today, but are probably expecting some hawkish signals on quantitative tightening and in the new staff projections. That said, there is still little evidence that the ECB policy is a key driver of EUR/USD. We, therefore, think only a 75bp hike or the explicit announcement that QT will start at a specific date in early 2023 will be able to drive a large EUR reaction. Our base-case scenario is that EUR/USD ends today's sessions around the 1.0600-1.0650 area today. As discussed above, this could signal that the dollar's bear trend may have indeed halted for now, and favour a return to 1.0500 in the near term.

The [Swiss National Bank](#) is also announcing monetary policy today (0830 GMT). The stabilisation in inflation around 3% should allow a downshift to 50bp after September's 75bp rate hike. This should be broadly in line with market expectations, and the impact on the franc may prove relatively muted. We continue to forecast CHF nominal appreciation in the first half of next year.

Francesco Pesole

➔ GBP: No fireworks by the BoE

[We expect 50bp](#) by the Bank of England today as well. The 75bp hike in November appeared to be a one-off move, as the BoE simultaneously delivered a rather explicit pushback against hawkish market rate expectations. The latest indications about the terminal rate were quite vague but

suggested levels above 5% would be too restrictive. We currently forecast another 50bp hike in February, which would bring the tightening cycle to an end as rates hit 4.50%.

The swap market is fully pricing in a 50bp hike today, and we doubt the reaction in sterling will be meaningful. EUR/GBP may be more impacted by potential surprises from the ECB, while some stabilisation or modest recovery by the dollar may cap GBP/USD and prevent 1.2500 from being tested before year-end.

Heading into the new year, we still see a preponderance of downside risks for GBP/USD as hawkish central banks (above all, the Fed) hiking into a recession point to the underperformance of highly risk-sensitive currencies like the pound.

Francesco Pesole

CEE: External factors cannot offer much more to the region

In our view, the initial market reaction after the Fed meeting for the CEE region did not bring a significant change. CEE FX closed yesterday at or near new highs. However, with at least a temporary halt to the weakening dollar, momentum may start to falter in the region. For the past month, with the exception of the Hungarian forint, local currencies have been unable to lean on domestic support in the form of interest rate differentials, which have been on a downward trajectory. Global conditions, led by a weak US dollar, have thus been the main driver in recent weeks. Obviously, we will have to wait and see what the ECB does today, but in our view, the global environment cannot offer much more to the region before the end of the year.

The Czech koruna, which reached its strongest levels since mid-November yesterday, has benefited the most from the weak dollar in our view within the region, and we expect it to remain in the current 24.25-24.30 EUR/CZK range in the coming days. The Polish zloty could benefit for a while longer from positive news on Poland's access to EU funds, while we estimate that it still has some potential to benefit from the weak US dollar. Thus, it could try to test 4.67 EUR/PLN in the coming days. The Hungarian forint has strengthened by almost 3.5% over the last three days in response to progress in negotiations with the EU. We still expect it to approach 400 EUR/HUF by the end of the year, but at a more cautious pace given that there is still some work to be done on the EU front and we have a central bank [meeting](#) next week. Thus, in our view, the Romanian leu has the most potential at the moment to take advantage of the weak US dollar and favourable global conditions for the CEE region and could test 4.91 EUR/RON again.

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