

FX: Strong dollar remains the only game in town

Resilient US growth, a hawkish Federal Reserve, and misfiring overseas economies are driving the dollar higher for a third straight month. We are deferring our call for a dollar sell-off this year, but ING's 2024 house forecast of three-quarters of negative US growth and 200bp of Fed easing should finally deliver a dollar reversal



The dollar looks set to hold its gains into the end of the year

The dollar has rallied about 2% since the last FOMC meeting in September, when the Fed cut in half its forecast for 2024 easing. Higher rates across the US curve since then have clearly helped the dollar. Our calculations suggest that the US 10-year Treasury yield at 5.00% would be consistent with EUR/USD trading at 1.02 [given their recent relationship](#).

Even though November and December are seasonally weak months for the dollar, it is hard to call a turn in the dollar trend before year-end. US data is showing no signs of turning just yet and indeed large data revisions suggest the US consumer may have larger spending power than previously thought. For that reason, it seems hard for the market to completely price out the risk of one last Fed hike before year-end. This should keep short-dated US yields anchored above 5% and prevent the dollar from falling too far during any corrections.

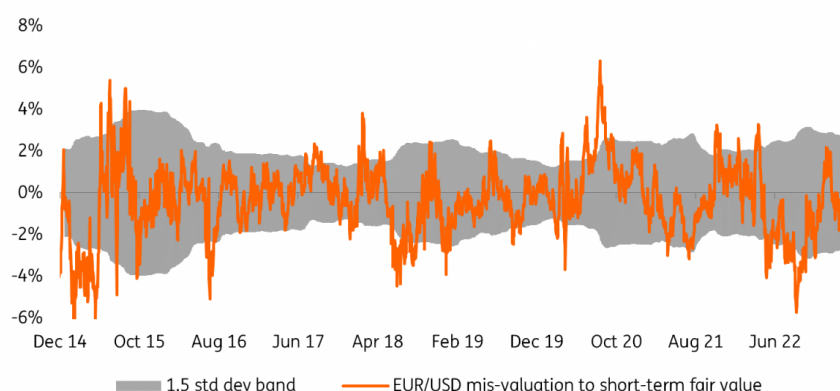
Looking into 2024, our call for US economic and rate convergence with stagnant growth elsewhere in the world should mean the dollar turns lower. Our calculations point to EUR/USD still heading up towards the 1.18 area in the second half of 2024 based solely on our house calls for the Fed and European Central Bank policy trajectories. Yet as we have seen repeatedly, policy rate differentials are not the sole driver of EUR/USD.

Currently, we estimate that EUR/USD contains a 2% risk premium – a risk premium that can extend to 6% during times of extreme stress in the eurozone. A low growth environment in the eurozone and [political uncertainty over the re-introduction of the Stability and Growth Pact](#) will keep that risk premium in the euro and means that EUR/USD ends this year near 1.06 and that its best levels of 2024 may be closer to 1.15 rather than 1.18.

There is also the extreme precedent of 2001 when EUR/USD failed to rally despite a 500bp Fed easing cycle. We doubt eurozone asset markets are as unattractive now as they were back then – but the situation bears watching.

Elsewhere, policymakers in China and Japan will continue to support their currencies and be praying for a market-led turn in the dollar. Incidentally, the strongest G10 currency this year remains the Swiss franc, as the Swiss National Bank has been busy selling from its plentiful FX reserves to drive the franc stronger for monetary purposes.

EUR/USD currently contains a 2% risk premium



Source: ING

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