

FX Daily: Back the dollar

FOMC day has finally arrived. The Fed is widely expected to announce the start of its tapering of bond purchases. We all assume the Fed will want to tread very carefully as it exits super-loose monetary policy. Yet the Fed has more reasons than many to worry about the persistence of inflation and any acknowledgment of this should lift US rates and the dollar.



Fed Chair, Jerome Powell

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📈 USD: Does elevated US inflation still largely reflect transitory factors?

The highlight of today's session will be the FOMC statement at 1900CET and Chair Powell's press conference at 1930CET. There are no new projections this month, meaning no new Dot Plots, but the statement should confirm that the [Fed will start to slow its bond-buying programme](#) by US\$15bn per month over the next eight months - effectively concluding its latest wave of QE by next June.

The dollar bearish case today is that the tapering is widely expected and an inherently dovish Fed, concerned about upsetting the bond market, does not change its statement substantially. This will keep the market guessing about when the Fed starts its tightening cycle. And the dollar could get

hit if Powell emphasises that tapering does not mean tightening or that the bar is substantially higher for the Fed to decide on tightening than it is on tapering.

Yet at some point, the Fed is going to have to acknowledge that elevated inflation does not 'largely reflect transitory factors'. Many dovish central banks around the world are already doing this and should the Fed start to show greater concern about this today, US rates and the dollar could get a boost. We are still amazed that the forward USD OIS curve still only prices short-dated US rates around the 1.35% area in three years' time, when the September Fed Dots show a median Fed expectation of rates at 1.80%. You would think these Dots only get revised higher in December.

We, therefore, do not want to miss out on a dollar rally on the Fed shifting its tone and would prefer to back the dollar today - particularly against the low yielders of EUR and JPY.

Also today look out for the October ADP reading and ISM services, both giving insights into Friday's NFP. With the Fed starting tapering, arguably US rates markets become more sensitive to US data. The consensus seems to be for around a 400/450k increase in both ADP and Friday's NFP.

DXY held support around 93.30/50 last week and today's FOMC could be the catalyst for a test of big resistance at 94.50/70.

📌 EUR: Will big support at \$1.1500 be tested?

We have become increasingly bullish on the dollar over recent months and see today's Fed meeting as a potential catalyst for EUR/USD to test major support at 1.1500. The Fed story is probably the best chance EUR/USD has of breaking 1.1500 this year, since December seasonal trends tend to be dollar negative.

From the Euro's perspective, we note that European stock markets are performing well (rotation into European equities to help the EUR?) but the more dovish ECB has a stronger case to push back against the pricing of rate hikes this year. We also note that EMU peripheral debt has reversed recent losses, suggesting investors are less concerned about the ECB being harried out of bond-buying programmes.

As above we favour EUR/USD to test 1.1500 today. Very few changes to the Fed statement could see EUR/USD spike to 1.1625, but we see a move back to 1.1690 or a close above 1.1700 as highly unlikely.

Elsewhere, EUR/CHF continues to hover near the lows as investors second-guess whether the big FX interveners are going to have to scale down their own (albeit FX denominated) versions of QE. Israel has already allowed \$/ILS to fall to the lows of the year. Will the SNB allow EUR/CHF to drop too? We would be surprised if the SNB were to step back decisively. The nominal trade-weighted CHF remains [near all time highs](#) and the SNB does not have an inflation problem. We expect 1.05 to prove a floor into year-end.

➡ GBP: Correction already underway

In our [BoE preview](#) we had felt that EUR/GBP could correct to 0.8500 on our baseline scenario of a split BoE vote to hike and some indirect rate protest via the CPI forecast. EUR/GBP is already trading 0.8500, suggesting slightly higher levels - e.g. 0.8540/60 - could be seen on BoE-day tomorrow.

Given we're bullish on the dollar, Cable looks like it can probably press and potentially break good

support at 1.3570/3600.

PLN: 50bp rate hike to provide temporary support

The National Bank of Poland (NBP) meets to set interest rates today and our Polish team is calling for [an above-consensus 50bp hike](#) in the policy rate to 1.00%. Driving that view should be strong upward revisions to CPI projections released today, with CPI potentially seen averaging 5.3% in 2022 and around 4% in 2023. As the team notes, the composition of Polish growth, more consumption and less exposure to the auto sector is inflationary.

Having seen the NBP as a policy laggard, the market is now pricing a reasonably aggressive tightening cycle, with the 12 x 15 PLN FRAs pricing 3m Wibor at 2.90%. That is a big change from the pricing of 1.30% barely over a month ago. Market pricing probably makes the bar quite high for a hawkish surprise from the NBP, yet an aggressive 50bp hike from the NBP could briefly see EUR/PLN trade to the 4.55/58 area. However, conflict with Brussels into year-end warns of renewed PLN under-performance and our Polish team prefers EUR/PLN to return to the 4.60/65 range over coming weeks.

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