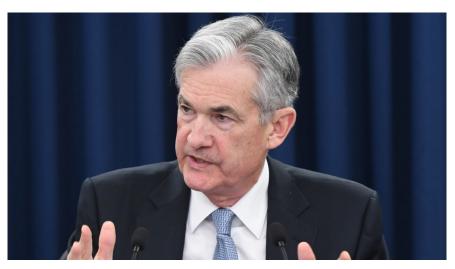
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Buy the hawkish Fed rumour, sell the gradual fact

If history were to repeat itself, we would expect the US dollar bear trend to resume after today's Federal Reserve meeting



Source: Federal Reserve

USD: Another 'buy the hawkish Fed rumour, sell the gradual Fed fact' move?

There's no doubt that short-term momentum favours the US dollar right now – after the Bloomberg dollar spot index pierced through the 200-day moving average (with one eye now on the year-to-date high below 1160). But the extent to which this is due to temporary factors like an unwind of short positions, US data divergence or an easing of US political risks – or something indeed more enduring – will in our view become much clearer after today's FOMC meeting. Unless we get an out-of-character hawkish signal in the statement – one that explicitly alludes to a faster pace of tightening than previously anticipated – then we think the Fed runs the risk of disappointing markets; at the very least, it should place a cap on any further hawkish repricing at the front-end of the US rate curve (note we've already seen short-term three-year forward rates rally around +60bp year-to-date). In theory – and indeed if this is one of the root causes behind FX moves in April – then this should also temper any Fed tightening-led US dollar sentiment (especially if we get a fairly benign US wage inflation print in Friday's April jobs report).

It's not unusual in the latter stages of a Fed tightening cycle to see a narrow window of dollar strength ahead of an FOMC meeting; but the reality of a gradualist central bank more often than

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not leads to a 'buy the hawkish Fed rumour, sell the gradual Fed fact' type of price action in the dollar. The current backdrop draws strong parallels with the run-up to the Nov-17 FOMC meeting – which also saw a broad +4% correction in the USD (albeit more drawn over a two-month period).

If history were to repeat itself, then we would expect the USD bear trend to resume after today's FOMC event. Should the USD's momentum continue after a status-quo Fed statement – then this move may be less fickle than we originally thought. But while the White House has been driving the agenda for much of 2018 – strangely, today's 'non-event' Fed meeting could hold the key to global markets over the next few months. Over to you, Chair Powell.

EUR: Expecting the 1.20 handle to be regained on a status quo Fed statement

The advanced 1Q Eurozone GDP release will be in focus today as investors seek to gauge the overall extent to which economic activity slowed down earlier this year. Our economists are looking for a 0.4% quarter-on-quarter print in line with consensus – but the data-sensitive euro will likely be highly sensitive to any slight deviations from this outcome (in either direction). More pressingly – and what matters for the EUR looking ahead – is the propensity for the Eurozone economy to recover from a softer 1Q reading. We also get the final April eurozone manufacturing PMI print today. We would expect EUR/USD to move back above 1.20 on a status quo Fed.

CEE FX: Look for short-term PLN vulnerability from the EU budget proposal

After the thin liquidity-driven sell-off in central and eastern Europe FX yesterday, the focus today turns to the presentation of the new EU budget proposal for 2021-27 and the outlook for the distribution of cohesion funds into CEE countries. The headlines may be modestly CEE FX negative given the expected cut to the overall funding (i.e. due to Brexit) – as well as the likely linkage of the funds to "the rule of law". The Polish zloty will likely underperform its CEE peers given its recent disputes with the EU. We note that the introduction of the rule of law clause must be unanimously agreed and thus warrants Poland's approval (which would be unlikely if the proposal is too harsh). We also note that the recent Czech koruna weakness is materially increasing the odds of a Czech National Bank hike in 3Q – which is currently underpriced in markets.

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