USD: Fed powers through

Some FOMC members pointed to the need for monetary policy to become modestly restrictive. Still, we don't think the Fed will move interest rates above the terminal rate, as growth is set to slow next year

Source: iStock

USD: The Fed powering through

The FOMC Minutes confirmed the clear tightening bias and a number of participants even pointed to the need for monetary policy to become modestly restrictive. While we look for the Fed to continue powering through with more rate hikes (one more this year and three next), it is not our base case that the central bank will move the level of interest rates above the terminal rate (that is making the policy restrictive) partly because our economists look for a moderation in US GDP growth next year (i.e. from 4.2% quarter-on-quarter annualised in 2Q18 to below 2% in 1Q19) as the effect of the fiscal stimulus wears off and the lagged effect of a strong USD and higher interest rates kick in. While this should take the wind out of the dollar's sails next year, for now, the prospect of higher US rates in an environment of heightened concerns about trade wars is a clear negative for emerging market FX. In its semi-annual FX report, the US Treasury refrained from labelling China a currency manipulator, though Treasury Secretary Steve Mnuchin expressed concerns about the lack of currency transparency.

EUR: Gravitating towards the EUR/USD 1.1500 level

EUR/USD continues to hover around its gravity line of 1.1500, with the somewhat more hawkish FOMC Minutes providing the catalyst for the cross to break below the 1.1500 level again. We expect the cross to remain stuck around the 1.1500 level for the rest of the year.

GBP: No sufficient progress

GBP has seen a fairly limited reaction to the lack of progress in the EU summit as such an outcome was widely expected by markets since the breakdown in talks on Sunday. Yet, the more conciliatory message from Prime Minister Theresa May (compared to the Salzburg summit) and the EU proposal to extend the transition period by one more year point to the willingness of all parties to reach a deal, in turn suggesting less pronounced downside to GBP for now (partly due to sterling's already very stretched valuation).

KRW: Hiking signals may see won outperform in bleak Asian FX universe

As expected, the Bank of Korea remained on hold (see 5 reasons why the BoK should not hike). We do not believe a hike is something the Korean economy needs, but government pressure is building and two BoK members actually called for an increase. As our latest Asia FX TalkING shows, that sentiment (albeit largely priced in) may see the Korean won outperform the Asian FX bloc – assuming USD/CNY stays fairly stable. Our 3M forecast for USD/KRW stands at 1120 – with an outside chance of 1110.