

What a shift in Fed Dots would mean for G10 FX

In advance of tonight's FOMC meeting and new economic projections, we take a quick look at what any shift in the Fed's Dot Plots would mean for G10 FX. Correlations between expectations for the Fed easing this year and G10 FX are strongest for USD/JPY. Were the median Fed expectation for easing this year to shift to just two cuts, USD/JPY could push through 152



Much focus on the Fed Dot plots tonight

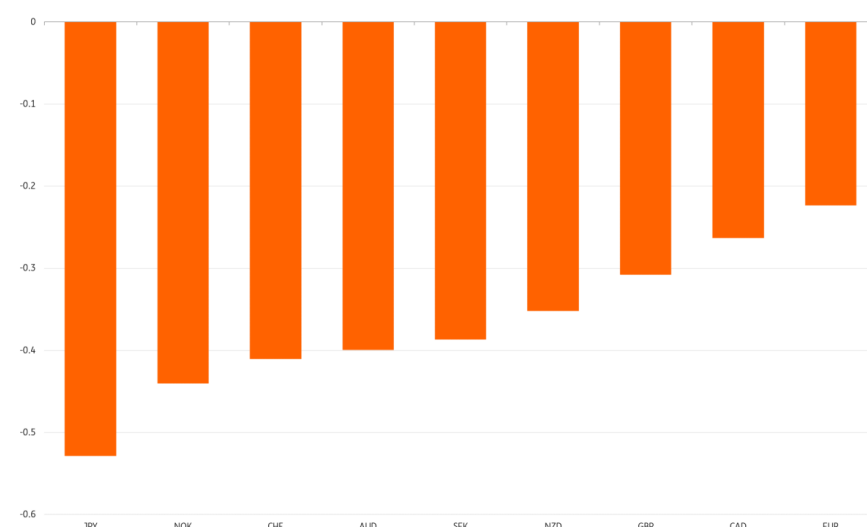
Tonight sees the results of the March FOMC meeting, where we will see a new statement, a new Summary of Economic Projections (SEP) and Fed Chair Jay Powell hold a press conference. Perhaps of most interest to the market is the SEP release and, in particular, the median Dot Plot - or the median forecast of Fed members - for rate cuts this year. The [last SEP release in December](#) showed the Fed expecting to cut rates three times this year or by 75bp. ING's US economist, James Knightley, [writes that on balance](#) the median Fed forecast for 2024 rate cuts probably stays at 75bp. But he notes that it would only take two Fed officials to shift their thinking for the median Dot to move to 50bp from 75bp of rate cuts for this year.

The Fed Dots are important for FX in that they help determine market pricing of short-term dollar interest rates and dollar pricing in general. The dollar sell-off seen late last year was driven by investors falling over themselves to price an aggressive 2024 Fed easing cycle. By the end of last

year, investors were pricing seven(!) 25bp rate cuts for this year. The connection to the Fed Dots is the following. Strong US activity data this year (particularly jobs data) plus sticky inflation have seen investors massively pare back expectations for Fed easing. And by late February, investors were pricing just three Fed rate cuts this year - the same as the Fed Dots.

Going into tonight's FOMC meeting, market expectations are now hovering around 75bp of cuts for this year. Arguably, those Fed Dots are proving a floor for those expectations. However, were the SEP to show a median expectation of just 50bp of cuts, that floor would drop and both short-term US interest rates and the dollar would rise.

G9 FX correlations versus 2024 Fed easing expectations



Source: ING

How would G10 FX react to 50bp of easing this year?

The dollar would likely rally on a shift in the Fed Dot Plots to 50bp of easing this year. Our chart above shows the daily correlations between non-dollar G10 FX currencies and pricing for the 2024 Fed easing cycle. In other words, when Fed easing expectations are cut, the dollar generally rallies against the rest of the G10 FX currencies.

Of note in this correlation chart is the Japanese yen as the consistent underperformer when these Fed expectations shift. That is a little surprise since we thought perhaps the higher beta currencies like the Norwegian krone or Swedish krona would be in the lead here.

Suffice to say that with USD/JPY now knocking on the door at multi-year highs at 152, a shift in the Fed Dots to just 50bp of easing in 2024 could well be the catalyst for USD/JPY to surge to new highs. As discussed in our articles over recent weeks, we were in Tokyo recently, and local accounts felt that 155 would be the level at which the Bank of Japan would intervene to sell FX and protect the yen.

Based on this event risk, we think that one-month USD/JPY implied volatility is trading too low, at under 8%.

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