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FX Tech Flash

Will Fed Deliver the Dovish Tilt?

DXY Objectives Met; Focus Next on FoMC… and ECB Forum

Our call in the last FX Tech Flash on 10th Jun (see here) cautioning for a sympathetic near term rebound for the USD played out well as dollar index more than retraced its post-NFP decline higher and met 2 out of our 3 objectives.

Key focus is on FoMC policy decision this Thu (2am SG/KL time). While markets may not be expecting a cut at the upcoming meeting (about 20% chance of a cut implied via Fed fund futures), the odds for a cut at the 31st Jul FoMC is way higher at >80% and nearly at 100% for the Sep FoMC meeting. In terms of the magnitude of rate cut expectations, markets are looking for about 60bps cut this year.

Softer than expected US data - Empire manufacturing, NFP, wage growth, ISM Mfg, ADP employment; a series of dovish Fed speaks from Powell, Clarida and Bullard and ongoing concerns of US-China trade war may suggest that the Fed could potentially signal a shift in its tone or guidance on rate outlook/ economic assessment but we are cautious of markets' aggressive expectation for Fed to cut.

We explore the potential scenarios in the following page.

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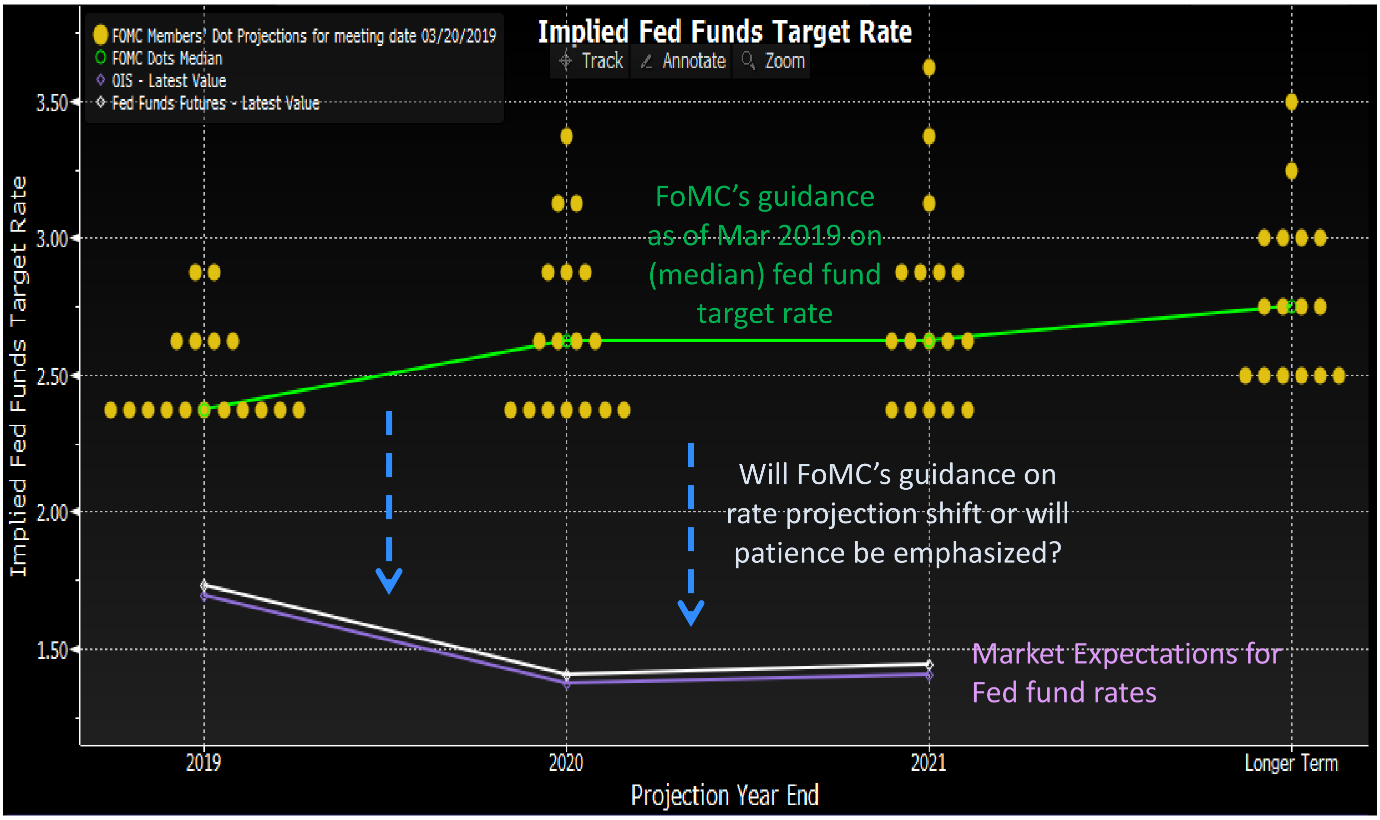
Fed Dots Plot (as of Mar2019 FoMC): Will the Dots Shift on Thu?



Source: Bloomberg, Maybank FX Research & Strategy

Potential Scenarios to Consider…

(1) **If Fed Sounds Less Dovish than Market Expectations…**

The USD could be firmer in the scenario that Fed sounds less dovish than expected (either via no change to dots plot or an emphasis on patience on rate moves) especially with USD still retaining the crown for being the higher yielder in DM FX world. USD could well retain its support against lower yielders and Asian FX including KRW, TWD, SGD and THB.

If we stretch this scenario a little further, where we get a scenario of less dovish than expected Fed, alongside softer US, global PMI data (if they turn out to be on Fri) and re-escalation of geopolitical tensions (over Iran), risk sentiment could be dampened. Then USD could still end up better bid and probably more so against AXJs. In this sub-scenario, JPY could join USD in the safe-haven proxy camp.

(2) If Fed delivers a Dovish Tilt…

However if Fed delivers a dovish tilt via forward guidance (i.e. dots plot to indicate rate cuts) or decide on a premature end to balance sheet unwinding, we believe USD upward pressure could ease off.

This brings a case of **Fed easing vs. ECB on hold** (though ECB still in accommodative stance) **could see USD play catch-down to EUR**. This could weigh on the dollar index.

DXY Technical Outlook: Tentative Signs of Bearish Reversal Setting In

DXY was last seen at 97.42 levels. Daily momentum turned mild bullish while stochastics is rising from oversold conditions. Upside risks not ruled out but we watch out for confirmation of a potential short term "hanging man candlestick pattern" (characterised by a long lower wick and short body at the top of the candlestick). This is typically a bearish reversal.

If confirmed (i.e. DXY price action lower today), this could signal a softer DXY ahead. Key support at 97.10 (100 DMA, 38.2% fibo), 96.60/70 (200 DMA, 50 % fibo). Resistance at 97.6 (23.6% fibo retracement of 2019 low to high), 98.3 (2019 high).

DXY (Daily): "Hanging Man" Pending Confirmation

Source: Bloomberg, Maybank FX Research & Strategy

ECB Forum - Any Surprise?

ECB forum is underway in Portugal and will last till Wed. This is of interest as market expectations for more ECB easing has gathered pace after Draghi said at the last ECB meeting (6th Jun) that the Governing Council had been debating options from more QE to rate cuts.

ECB President Draghi will make another 2 speeches – today and tomorrow. A reiteration of dovish assessment on economic outlook and ECB's pledge for accommodation is likely.

Markets are likely to watch out for any potential discussion on ECB's policy tool of choice it may use in the future if needed. Such discussion could weigh on the EUR.

But at this stage, we see a low risk of ECB making another drastic dovish shift in policy stance especially after the recent change in forward guidance - *ECB said that rates will be on hold till 1H 2020*. Recent comments from ECB officials seem to suggest there is no broad support for further rate cut unless financial conditions are tightened. QE on the other hand, could be challenging and may send a wrong signal to markets as the ECB has only recently ended QE in Dec-2018. Restarting QE may also not receive the Governing Council's support. TLTRO-III or basically liquidity injection at cheap rates already announced, is probably easier to implement.

So the risk is that the ECB may sound less dovish than market expectation. As a result, EUR could drift higher.

EUR Technical Outlook: Risks Skewed to the Downside

Source: Bloomberg, CFTC, Maybank FX Research & Strategy

EUR was last seen at 1.1235 levels. Daily momentum is mild bearish while stochastics is falling. Risks may be skewed to the downside. Immediate support at 1.1220 (21, 50 DMA), 1.1190 levels. If these levels hold up, we could see EUR drift higher towards 1.1270 (100 DMA), 1.1300 (trend line resistance) before 1.1360 (200 DMA). Failing which, downside play towards 1.1110 (double bottom in 2019) should not be ruled out.

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