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FX

Global

FX Flash

USD Could Remain Supported on *Dips*

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USD Softens as Fed Still Sees 3 Cuts for 2024

The US Dollar got the cue to fall from the Fed overnight. The FOMC left the Fed Fund target rate at 5.25-5.50% as widely expected overnight. More noteworthy was the quarterly summary of economic projections (SEP) which raised longer-run rate slightly from 2.5% to 2.6% as well as the median policy rate for 2025 and 2026 by around 25bps to 3.9% and 3.1 % respectively (from 3.6% and 2.9%) whilst keeping the median policy rate projection steady for 2024 at 4.6%. That effectively keeps rate cut projections at three for 2024, reduces the number of cuts for 2025 from four cuts to three and the pace is maintained for 2026 (vs. Dec proj). Powell mentioned in his press conference that while it is hard to say if terminal rates will be higher, rates are unlikely to go back to low pre-pandemic era levels. That tweak higher on the longer-run rate was perhaps a reflection of that.

Other economic projections were shifted rather materially

GDP forecasts were bumped up substantially through 2026 from 1.4% to 2.1% for 2024, from 1.8% to 2.0% for 2025 and 1.9% to 2.0%. Stronger growth projections likely spurred the drop in rate cut projections for 2025. In addition, **core PCE inflation forecast was raised to 2.6% for 2024 from 2.4%**, while forecasts for 2025 and 2026 were held unchanged at 2.2% and 2.0% respectively.

There was no decision made on quantitative tightening (QT) but the run-off of QT could happen "fairly soon" according to Powell in his press conference but he cautioned that it may not mean it could end sooner. A moderation in the pace of tightening could allow market room to adjust, prevent shocks from emanating in the financial markets (reference to 2019) and even allow the QT to run for longer. Regardless, this hint of concern for liquidity stresses may also mean that the Fed would be more open towards easing.

Market Reactions to the Fed

The market reaction was subdued. UST 2y yield eased only a tad, around 6bps lower from overnight high of 4.66%. The shift in the longer-run rate spurred a bull steepening of the US treasury curve. 2y10y spread narrowed from -40bps to around -34bps. The USD softened only a tad at the release of the statement and the SEP. We attribute the muted initial reaction to the fact that (1) a cut was dropped from 2025 median policy path projection (4 to 3), (2) the number of participants looking for at least three cuts fell a tad from 11 (Dec) to 10 (Mar), (3) GDP and core PCE forecasts were raised. **Powell's press conference was relatively more dovish** compared to the SEP and the policy statement. US bourses were back at intra-day high after the conference. The USD fell against most currencies but remained considerably elevated vs. the JPY. Gold rose +1.8% from Wed low. **The market reactions have panned out largely in line with our expectations but the growth, inflation, longer-run rates upgrades could provide stronger underpinnings and potentially slow the USD decline.**

Powell's Press Conference Sounds Slightly More Dovish Than the SEP

Powell's press conference provided the greenback room to soften further. He first reiterated that the dot plot is not a plan and there could be developments in between meetings that could necessitate a shift in the course of policy. **The risk to policy at this point is actually two-sided** while inflation has eased substantially but it remains too high. He also warned that should there be a significant weakening in labour market, the committee could also take action. In contrast to **the somewhat hawkish SEP, Powell's press conference sounds considerably more neutral or even lean a tad dovish.**

Should Not Overreact to Jan-Feb Inflation prints, Seeks Confidence

A lot of speculation on rate cut projections for this year was shifted in recent weeks due to the release of the inflation numbers for Jan and Feb that surprised to the upside. Powell mentioned that there could be some seasonal factors that keep the numbers elevated in the early part of the year. The firmer prints could be just a bump and the committee would want to assess incoming data to confirm if it is just that or signs of something more. Taken together, he said **Jan and Feb inflation prints have not changed the picture** that disinflation is still progressing, albeit at a bumpy pace. The committee is thus refraining from over-reacting to these prints but will continue to monitor and seek evidence that the good progress of disinflation in 2023 will sustain in 2024.

During the QnA, Powell reiterated an important point that **strong hiring does not deter the Fed from easing.** There has been some discussion that strong immigration has increased labour supply. Powell mentioned that the there could be strong job gains due to the increase in labour supply that feeds into demand. However, inflation could still fall as seen in 2023. In order for inflation to trend toward 2%, wage growth has to ease to a sustainable pace. **His words suggest that when it comes to labour reports or specifically NFP, the risks are actually asymmetric.** Strong job gains do not necessarily keep the Fed from normalising monetary policy but signs of weakness are more certainly likely to nudge the Fed into cutting more. Signs of stabilizing wage growth is still important and should be monitored. The current labour market in the Fed's view is robust with few signs of layoffs (as evidenced by low jobless claims). This could explain why the median rate projection path is raised beyond 2024.

There was no decision made on quantitative tightening (QT) but the run-off of QT could happen "fairly soon" according to Powell in his press conference but that may not mean it could end sooner. A moderation in the pace of tightening could allow for better market adjustments, prevent shocks from emanating in the financial markets (reference to 2019) and even allow the QT to run for longer. He mentioned that the end goal could be a balance sheet that consists of mostly treasuries and he characterized the current liquidity conditions as "abundance" and the end goal could be "ample".

With regards to the timing of the first cut, Powell gives not hint at all and stress that the Fed is data dependent. Fed Fund Futures now imply around 73% of a rate cut in Jun, rising from below 60% seen before the event. Total rate cut expected for this year is now around 84bps.

Where was the Surprise?

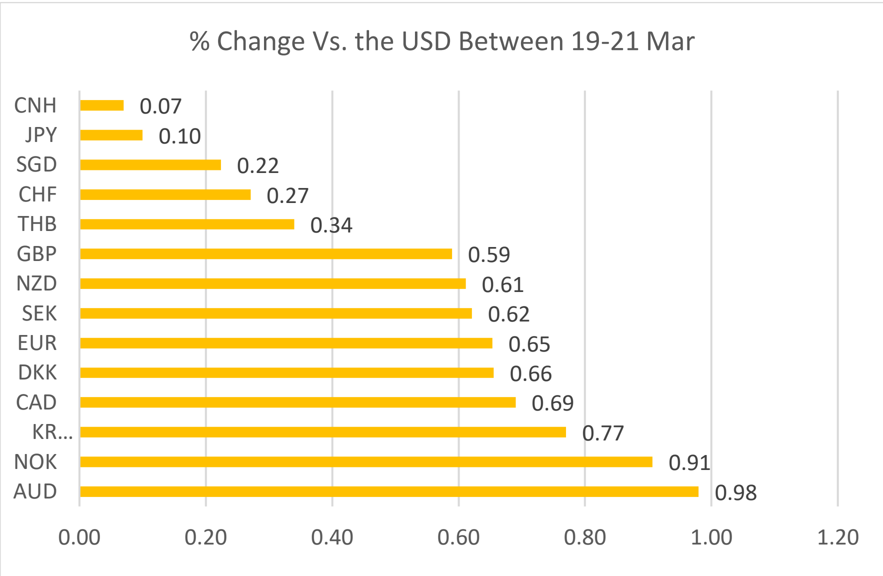
While markets were focused on the number of rate cuts projected for this year, the Fed essentially surprised with a shift in policy projection for 2025 instead. Markets' suspicion that the longer-run rate could be raised was validated but the revision was small. Still, that could be the real reason for USDJPY to remain rather elevated above 151.00 as Fed's robust growth projection and shallower terminal rate stand in contrast to BoJ's accommodative monetary policy stance. Both major central banks are taking their time and a lot of caution to pivot in their monetary policies and that keeps USDJPY from falling too much.

Looking forward, the USD could continue to remain supported on dips as the recent projections feed the narrative of US exceptionalism. The growth projections still paint a picture of a very gradual slowdown but upgrades suggest that risks of a no-landing scenario for the US seem to have increased. The longer-run rate was tweaked 0.1ppt higher and these robust economic projects suggest the Fed could remain slow-moving in terms of monetary policy easing. **That could also mean that the decline in the USD would be more gradual and its pace largely depends on global growth outturns this year.**

UST 10y yield was hardly changed at the end of Powell's press conference. Afterall, growth projections were raised. The Fed is very much data-dependent with regards to policy path. **A slower fall in UST yields could also mean a slower recovery in Asian currencies this year unless regional growth surprises to the upside.**

Next data that we want to monitor before the next Fed decision on 2 May is Feb PCE core deflator (29 Mar), Mar NFP (5 Apr), Mar CPI (10 Apr), Mar PCE Core deflator (26 Apr).

USD Soften Against Most Currencies, AUD leads in Gains



Note: % Change in KRW is taken from the movements this morning against the USD.

Source: Bloomberg, Maybank FX Research & Strategy

AUD led in gains in overnight session while JPY remains the underperformer. Expect We expect Asian currencies to strengthen modestly today.

DXY (Daily Chart) – Two-way Risks

Momentum indicators of the DXY index do not provide much directional cues. This pair just broke out of the rising wedge. Bearish extension could meet support at 102.98 before the next at 102.70 and 102.36. There could be more two-way trades in store for the DXY index within the 102.70-104.40 range in the near term.

AUDUSD (Daily Chart) – Back within Trend Channel

Source: Bloomberg, Maybank FX Research & Strategy

AUD led in gains in overnight session and was last seen around 0.6585. In line with our view stated in our AUD flash (dated 19 Mar, Pullbacks are Opportunities to Accumulate), AUD was the biggest beneficiary from FOMC. We continue to look for AUDUSD to rise to cross 0.6590-resistance and a break there to open the way towards 0.6670. Support remains around 0.6530-0.6560.

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