FX Insight

FX Strategy Update - Fed Frontloads, USD Bears Run into Fatigue

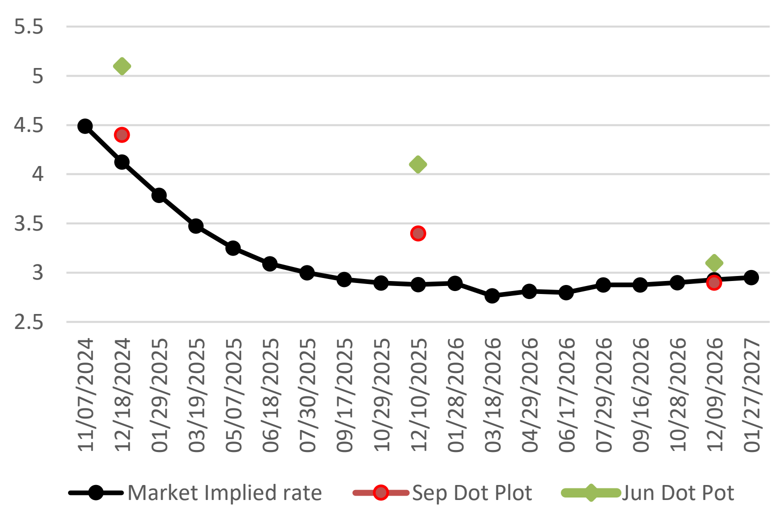
The Fed Validated Market Positioning

- **Fed lowers the benchmark rate by 50bps to 4.75-5.0% target rate with only one dissenter (Michelle Bowman) calling for a 25bps cut**. The statement was more dovish pointing out "job gains have slowed" and "the unemployment rate has moved up but remains low". However, the statement also highlighted that while inflation has made further progress, it still "remains somewhat elevated". In addition, "the risks to achieving its employment and inflation goals are roughly in balance" and this suggests **an arguably rather neutral tone after the relatively bigger cut undertaken today.**

- The summary of economic projection had rather conservative revisions (much like the one in 2019) where Powell had also characterized the first rate cut as a calibration. Given the current level of interest rate (about twice as high compared to 2019), the size of calibration somewhat corresponds (50bps now compared to 25bps then). As a result, the Fed Fund Futures did not shift much.

- **FX Strategy:** Overnight action suggests that the downside momentum of the USD has run into fatigue. Much of the action of the greenback could remain within the 100.60-102 range for a while yet. Data releases (both the US and that of the rest of the world) remain key for the USD with the US elections now likely to be the next main event to watch. Lower US rates continue to provide a benign environment for ASEAN currencies. We still expect CNY TWI to fall, AUDNZD could rise and CHFJPY to be a sell on rally.

Chart: Dot Plot Shifted Lower, Still More Measured Than Market Implied Policy rates



Source: Bloomberg, Federal Reserve, Maybank FX Research & Strategy

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Fed Cuts 50bps, Shifts Dots Plot

Fed lowers the benchmark rate by 50bps to 4.75-5.0% target rate with only one dissenter calling for a 25bps cut. The statement was clearly more dovish pointing out “job gains have slowed” and “the unemployment rate has moved up but remains low”. However, the fed also pointed out that while inflation has made further progress, it still “remains somewhat elevated”. In addition, the statement that “the risks to achieving its employment and inflation goals are roughly in balance” suggests an **arguably rather neutral tone after the relatively bigger cut undertaken today**.

That could explain why the initial kneejerk move lower of the USD against most currencies was limited, on top of the fact that markets have been evenly split on a 25bps cut and a 50bps cut based on the Fed Fund Futures pricing.

Dot Plot shifted To Frontload Rate Cuts into 2024, Maintains Pace beyond

The summary of economic projections was shifted accordingly with the median rate projection lowered 50bps to 4.4% from previously seen 5.1% in Jun, implying two more rate cuts within the year, in line with market expectations. The Fed maintains its pace seen in Jun, an accumulative rate cut of 100bps for 2025 and 50bps cut in 2026 to take policy rate to 2.9% then. This suggests that the pace of cut is still maintained at 25bps per quarter from 2025. The longer run policy rate was adjusted slightly higher to 2.9% from previously seen 2.8%.

GDP forecast was adjusted only slightly lower to 2.0% for 2024 from 2.1% seen in Jun. Growth is expected to maintain at this pace for the next three years.

Core PCE inflation forecast is downgraded to 2.6% and 2.2% for 2024 and 2025 respectively from previous 2.8% and 2.3%.

Unemployment rate forecast was raised to 4.4% for 2024 from Jun’s 4.0% and is expected to steady around this level for 2025 before trending lower to 4.3% in 2026 and then to 4.2% in the longer run (unchanged from previous).

Taken together, the summary of economic projection had rather conservative revision (much like the one in 2019) where Powell had characterized the first rate cut as a calibration. Given the current level of interest rate (about twice as high compared to 2019), the size of calibration somewhat corresponds (50bps now compared to 25bps then).

Table 1: Summary of Economic Projections

Variable (Percent)	Median				
	2021	2025	2026	2027	Longer-Run
Change in real GDP	2.0	2.0	2.0	2.0	1.8
June Projection	*2.1*	*2.0*	*2.0*		*1.8*
Unemployment rate	4.4	4.4	4.3	4.2	4.2
June Projection	*4.0*	*4.2*	*4.1*		*4.2*
PCE Inflation	2.3	2.1	2.0	2.0	2.0
June Projection	*2.6*	*2.3*	*2.0*		*2.0*
Core PCE Inflation	2.6	2.2	2.0	2.0	
June Projection	*2.8*	*2.3*	*2.0*		
Memo: Projected Appropriate Policy Path					
Fed Fund Rate	4.4	3.4	2.9	2.9	2.9
June Projection	*5.1*	*4.1*	*3.1*		*2.8*

Note: For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.

Source: Federal Reserve, Maybank FX Research & Strategy

Powell's Press Conference – We are not behind the curve

Powell clarified that a bigger start (of 50bps) is not a "hurried start" and he emphasized that the Fed does not think it is "behind the curve". The bigger cut "shows confidence" in the inflation trajectory. Whilst the unemployment rate forecast was raised, he also noted that the labour market remains rather strong and as such, the unemployment rate is still seen at steady at 4.4% in 2025 and trending lower in 2025.

Powell does not see anything in the economy that suggests a recession and throughout his press conference, he repeatedly mentioned that the economy is solid.

He also added that the pace of rate cut would be adjusted based on the data and "no one" should look at 50bps and extrapolate it as the new pace. The inflation target is still at 2% and this policy adjustment in rates as well can be seen as a monetary policy normalization. He even stressed that the current monetary setting is still restrictive, but it will take some time for the fed to reach neutral rate.

Market Reactions – USD Reverses Post Decision Losses, Fed Fund Futures Little Moved

Fed fund futures now look for the Fed to cut by another 70bps by the end of 2024 and roughly another 125bps by the end of 2025 to take the policy rate to 2.9% which is where the Fed has estimated the longer-run policy rate to be. **Fed's decision seems to have validated markets' positioning.** As such, there was little material shift in the Fed fund futures compared to where they were before the decision.

Equity bourses were in a mix of mild gains and losses after the event, likely due to the fact that the decision was a close call between 25bps and 50bps and as such, not much of a surprise. On top of that, Powell is decidedly balanced in his speech, or rather less dovish than what markets expected him to be with less concern expressed on the labour market, repeated mention of a solid economy along with the mild adjustments to the summary of economic projections. The 50bps cut was a sign of confidence that inflation is likely to reach its target and also a way to ensure that the Fed "stays" ahead of the curve and the economy could soft land. Given that it has undertaken a bigger cut, there is a possibility that the pace may even be more measured from here.

The DXY index slipped to a low of 100.21 last night before reversing higher back above the key 100.60-support and was last seen around 100.90. This suggests that even with a 50bps cut, the USD bearish momentum has run out of steam from the rates perspective and it is now up to global growth momentum outside of the US to take the USD lower.

Table 2: Market Implied Rate Trajectories for the Next 1Y

	Current Policy Rate (as of 12 Aug 2024)	Market Implied Policy Rates in 1Y (%)	Market Implied Policy Rate Cuts in 1Y (bps)
US	4.88	3.03	-185
Canada	4.25	2.53	-172
Eurozone	3.50	1.79	-171
UK	5.00	3.57	-143
Switzerland	1.25	0.51	-74
Australia	4.35	3.30	-105
Japan	0.25	0.47	22
China	1.70	1.40	-30

Note: Prices are taken as of 18 Sep 2024
Source: Bloomberg

Now the central banks are more synchronous in their easing Cycle

At this point, the Fed has also “caught up” with ECB on easing cycle given that both central banks have eased 50bps accumulatively thus far. Based on market implied rate, the Fed now has roughly another 180bps cut to go and this is on par with BoC, ECB, Riksbank. BoE, RBA are expected to cut less at -140bps and 105bps respectively. RBNZ is expected to cut more by 225bps. SNB only has 75bps more to go but is most likely to arrive at the lower benchmark rate at around 0.5% in 1Y compared to the Fed at 3.00% and ECB at around 1.8%. The benchmark lending rate is expected to be around 0.5% in 1Y but risks are to the upside given that BoJ is on the hiking cycle. We see potential for the CHF and the JPY to remain on a tear and the CHFJPY cross could remain a sell on rally, last at 168.20.

FX Strategy

DXY index may remain stuck within the 100.60-102 range in the near-term. Markets would watch data releases for a sense of global growth assessment. Eyes particularly on the Eurozone ZEW, PMI prints for Sep.

The yuan should continue to lag in recovery vs. the rest of its peers because of China’s economic fragility and the risk that a Trump victory might spur greater yuan volatility because of his tariff threats on China. Yuan should remain on the backfoot vs. most other DM peers in the medium term and another 5% fall in the TWI from here into 2025 could happen.

When it comes to rest of Asia, BI had started to cut yesterday, taking the cue from Fed’s pivot in Aug. This follows BSP which had started easing weeks ago. Rate cuts are less punitive for the local currencies at this point as UST 10y yield had dropped substantially, widening the yield differential in the favour of the local currencies. With the Fed easing narrative still entrenched, the US rates backdrop could continue to remain benign for regional currencies. And as such, it is also a benign environment for regional central banks to cut rates and support their respective economies, providing currencies concomitant boost.

Stark policy divergence may favour the AUDNZD as RBA continues to remain vigilant on inflation and as such supportive of the AUD while the NZD is at risk of being dragged by a deeper easing cycle of the RBNZ. AUDNZD may swing towards the 1.10 once more.

Safe havens CHF and the JPY are on a tear because of policy divergence and the CHFJPY could continue to trend lower given the policy trajectory. With only another 25bps hike expected for the BoJ at this point, balance of risks could be skewed to the upside based on modest rate trajectory priced in by markets. We continue to prefer to sell the CHFJPY on rally, last at 168. In a late cycle, JPYCHF could also be a more stable cross in times of risk aversion stemming from recession fears.

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