ECOWEEK

N° 17-34 // 22 September 2017

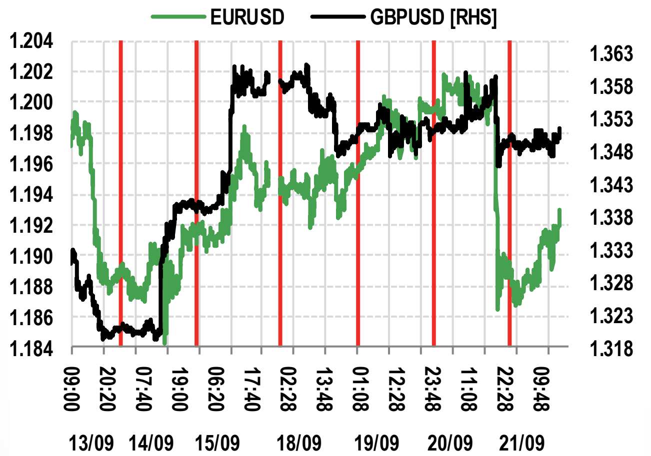
The dots drive the dollar

■ The EURUSD reacts to news in a very selective way as of late ■ The relevance of news depends on what it tells us about future central bank policy ■ The new rate indications ("dots") of FOMC members raise speculation of a December rate hike

The behaviour of Wall Street hasn't exactly been exciting in recent weeks. Volatility has been low, also on an intraday basis. Earlier this week the S&P500 even managed to stay in a 2 point range during most of the trading session. Watching this is a very good alternative to taking sleeping pills.

Foreign exchange markets have been livelier with sometimes significant intraday moves. Wednesday of last week (13 September) saw a drop in the euro in the afternoon. Media reported that the positive number for the US PPI was creating an anticipation of a strong CPI number the following day. There was also reference to an interview of House speaker Paul Ryan that a tax cut didn't need to be revenue neutral. ECB chief economist Peter Praet made a dovish speech stating that *"metrics of underlying price pressures remain anaemic. The entire distribution of inflation expectations still needs to shift a fair distance to the right*". On Thursday 14 September the US CPI did surprise to the upside but the dip in the euro was very short-lived. Investors must have thought this was not enough to turn the Fed more hawkish. The rally in sterling following a more hawkish message from the Bank of England may also have played a role. It seems investors that moved into sterling were selling the dollar rather than the euro, so EURUSD and GBPUSD showed a positive correlation.

EURUSD VS GBPUSD



Source : Bloomberg, BNP Paribas

The big move came this week on Wednesday, not so much because the Fed announced the start of its balance sheet reduction (this was expected and Wall Street even managed to realise its 42nd record close this year). It was all about the dots, the indications given by the FOMC members about the expected path for the federal funds rate and which point towards a hike next December. The ECB must have welcomed this: a stronger dollar/weaker euro gives it more leeway on what do to about QE at its meeting on 26 October. It must be hoping that US data will be sufficiently strong in coming weeks to justify a December Fed rate hike. The Fed wouldn't mind either. Judging by the dots, most FOMC members are keen to hike. In that case, with markets attaching a 64% probability to a rate increase, there would still be need for repricing. Wall Street might become less sleepy after all.

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