

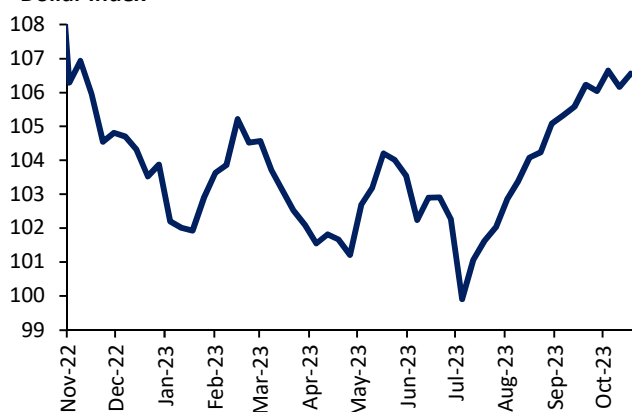
November 2<sup>nd</sup>, 2023

## **Fed: Pause for longer?**

In the last couple of months' dollar has gained steadily against its major crosses on back of safe haven buying and as economic numbers from the US continued to keep the momentum higher. YTD gains for the DXY has been to the tune of over 3% and driven not only by hawkish comments of the Fed governor, but also by prospects of more rate hike on the way ahead. US 10-year yields have risen to the highest level in 16-years on expectation that the Fed could raise rates one more time this year. US treasuries lent support to the dollar that has gained sharply in the last three months. Geopolitics is another factor that has changed dynamics for the dollar and US treasuries.

Israel troops are operating in "various parts" of northern Gaza, engaging with Hamas combatants and are also attacking them on the ground and from the air. The war between Israel and Hamas has also led to a flare-up in hostilities on Israel's northern border with Lebanon, where IDF forces have been engaged in escalating cross-border fire with the Iran-backed militant group Hezbollah in recent weeks. In the last couple of weeks, dollar traded in a wide range as market participants remained cautious ahead of the important FOMC policy statement that was released yesterday.

**Dollar Index**

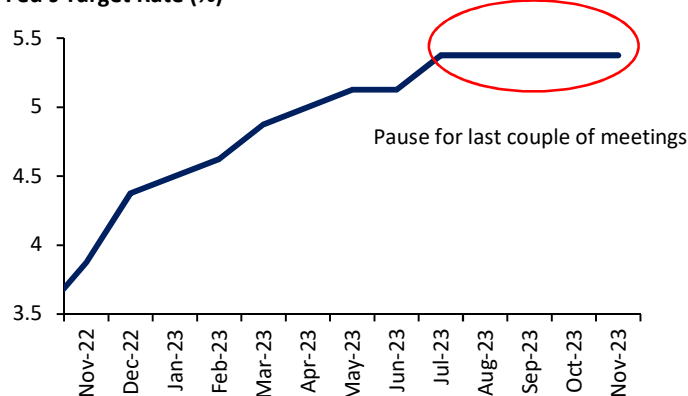


Source: Reuters

## **Fed appears less hawkish**

The Fed decided to take a pause on raising rates for the second successive meeting and kept open the possibility of further monetary tightening. The central bank could proceed carefully on future decisions amid signs that previous rate hikes will have an effect on the economy. The central bank Chairman added that it was "too early" to determine whether the rise in yields would last, even as the Fed acknowledged in its statement that tighter financial and credit conditions could begin to bite. The meeting came against a backdrop of persistent strength in the US economy, with consumer spending remaining high and unemployment historically low. Recent labour market data remains strong together with sustained growth on the wage front. Reaction on the US 10-year yield was negative and it fell to the lowest level in two-weeks, with declines accelerating after the release of economic data which included a weak reading on the US manufacturing sector.

**Fed's Target Rate (%)**



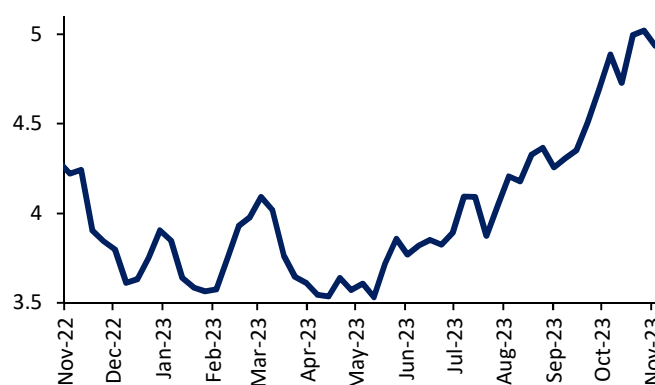
Source: Reuters



## Higher for Longer

As we mentioned above that US 10-year yields did retrace a bit and market participants are starting to discount that US interest rates could be nearing its peak. Most economies until now have shown resilience in the face of higher rates, but until when this resilience remains, is a question unanswered. Rising bond yields threaten deeper stress in the economy and expectation is on the rise that the US and the EZ could witness slowdown in the coming year. Now that the Fed has shifted to a “higher for longer” stance to combat inflation, the economy will have to make painful adjustments to the rising cost of capital. The Fed could decide to take a pause for longer and let the economy adjust to recent interest rate hikes. Corporates are likely to face consumers with tighter pockets and higher loan payments could squeeze spending.

US 10 Yr Bond Yields (%)



Source: Reuters

## Outlook

With inflation concerns still haunting the market, the Fed is keeping doors open for further rate hike. At the December meeting the central bank will release both its growth and inflation projections and any major deviation from the last forecast could trigger volatility. The current scenario of the US economy suggest that dollar gains could extend, but pace of rally would be slower. US 10-year yield that rallied to 16-year high could take a breather and also see some retracement. As far as the USDINR pair we expect that active RBI intervention could keep the currency stable despite uncertainty on the global front and rising geopolitical tensions.

Technically, for the Dollar index, we expect it to trade with a positive bias and on the higher side resistance is at 107.30 and 108.20 and support lies at 105.30 and 104.50. In case of the USDINR (Spot) bias remains positive and resistance is in the zone of 83.50 and 83.80 and support is at 82.80 and 82.50.

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# CURRENCY INSIGHT

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