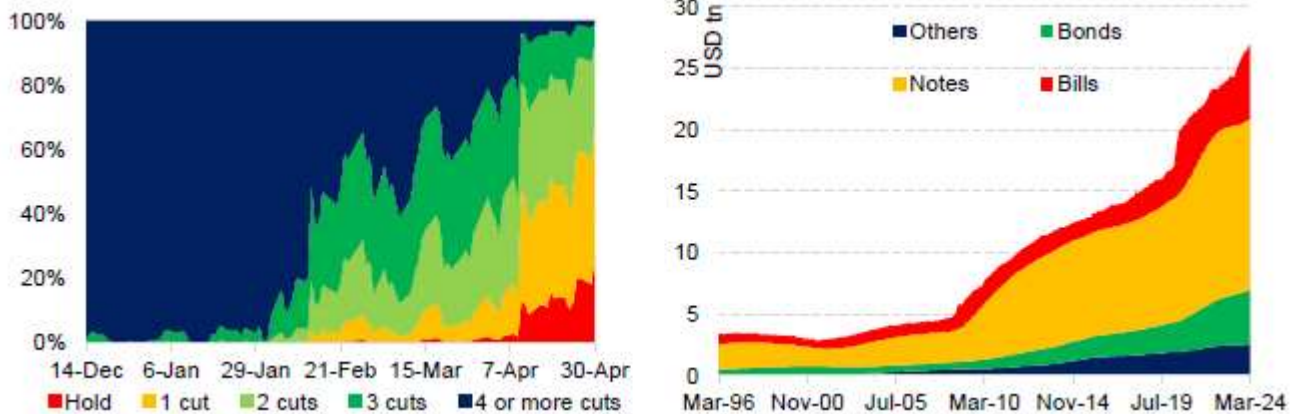


## Global Markets – Special FX

### Implications of possible US fiscal dominance on the USD

The USD rose in April with Fed June rate cuts being priced out, and fear of rate hikes being priced in. The ECB which had expressed independence on cuts moved to limit the fallout, while the BOJ was insufficiently hawkish and required MOF intervention to stabilize the JPY. The FOMC was less hawkish than feared, bringing the USD lower this week. A larger than expected cutback to QT might be seen by some as signaling fiscal dominance in the US especially given upside risks to treasury bond issuance after recent surge in bills – limiting the extent of strength in the currency and boosting gold prices.

### Exhibit: Fed funds rate Dec'24 probabilities (L) and outstanding US marketable debt (R)



Source: Axis Bank Business and Economic Research

### Jun Fed rate cut priced out, but 2024 rate hike priced out too after FOMC

The broad USD was weaker early in April, with softer US services PMI coupled with better Eurozone confidence, and persisted even after stronger payrolls. However, stronger US inflation and comments indicating ECB independence on rate cuts vis-à-vis the Fed pushed the USD up sharply. This was followed up with continued strong Eurozone data, and a walking back of the independence comments, leading the USD to glide lower. The BOJ did not adequately push back on the weaker JPY, leading to a test of 160 before being reversed by MOF intervention. The USD gained late in the month ahead of the FOMC, but reversed with a larger than expected cutback to QT as well as comments allaying fears of rate hikes.

### Fiscal dominance in the US would limit USD gains, boost gold

While the pace of QT has been slowed to more carefully find the correct level, some hypothesise that large fiscal expansion and potential increase in issuance of treasury bonds (as opposed to bills) is another reason for slowing QT. This brings into view potential moves towards fiscal dominance, which would keep rates lower than otherwise justified by the macro economy so as to ease government financing pressures. Such an environment would limit USD increases (with fiscal dominance likely to pick up only slowly elsewhere) at the same time as boosting gold – with anecdotes this is already happening, helped also by central bank demand.

### Limiting expectations of USD strength, while largely restating views

Potential for the fiscal dominance trade and walking back of ECB independence comments are likely to limit the scope of strengthening of the USD in the near term, with a test of par on the EUR no longer likely. However, we continue to expect some weakening in the EUR and GBP this year until Fed cut momentum increases in 2025. The BOJ has indicated comfort with a weaker JPY, though has enough levers to manage appreciation with a weaker USD – leading to postponement of expected appreciation. We also maintain views for CNY and INR.

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