

FX Viewpoint

Currencies
Global

USD: Markets debate a soft vs hard US landing

- ◆ Markets are debating a soft vs hard landing in the US...
- ◆ ... and, by extension, the Fed's easing path
- ◆ The USD's decline may have been overdone relative to rates

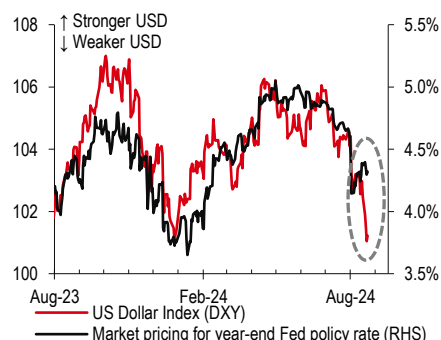
The USD angst has swung from localized recession concerns to a possible “risk on” US soft landing, but **the difference between a soft and hard landing¹ will be determined by economic data**. The market fixation is justifiably on US labour market data. Indeed, the preliminary benchmark revision to the number of workers on payrolls for the 12 months ended March 2024 (which normally passes unnoticed) caught market attention this time, showing a downward annual adjustment of 818k (*Bloomberg*, 21 August 2024). In other words, **the US labour market has been cooling more and for longer than what the initial monthly data suggested**.

A soft vs hard landing in the US will be data-dependant

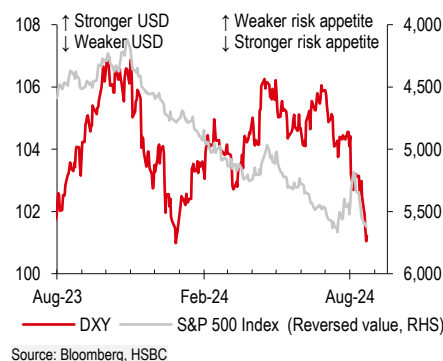
Meanwhile, the Federal Reserve's (Fed) minutes from the 30-31 July meeting showed that **the vast majority thought it would likely be appropriate to deliver a rate cut at the 17-18 September meeting**, if the data continued to come in about as expected (*Bloomberg*, 21 August 2024). But markets are currently pricing in about 100bp of Fed rate cuts for the rest of 2024 (*Bloomberg*, 22 August 2024) and it may seem difficult to “out-dove” such expectations. With only three scheduled meetings left in 2024, **market debate will probably focus on whether the Fed will deliver a larger 50bp cut at its September meeting**. While our economists' base case is a 25bp cut in September, the potential for a larger cut has increased.

The Fed will probably cut rates in September, but by 25bp or 50bp?

1. The broad USD weakness seems to outpace market pricing in Fed rates



2. The USD has not really moved in an opposite direction to risk appetite



The US Dollar Index or DXY hits year-to-date lows, and when plotting the DXY against market expectations for the Fed's policy rate at year-end 2024, we see a notable gap (Chart 1). But the gap does not seem to be explained by risk appetite, using the S&P 500 Index as a proxy (Chart 2). Admittedly, this remains a challenging period of time to argue for USD strength, but **we are still unconvinced by the idea of a trend decline unfolding in the USD** (Please refer to [FX Viewpoint – 16 August 2024 “USD: A sustained decline?”](#) for details).

The recent USD weakness seems to have overshoot what is implied by rates

¹ A hard landing is when the Fed increases interest rates and decreases inflation but at the cost of a recession and high unemployment; while there is not an exact definition of a soft landing which could include cases like a mild recession to no recession without very high unemployment (Engemann, K. M. (2023) *The Federal Reserve Bank of St. Louis*. Available at <https://www.stlouisfed.org/open-vault/2023/october/what-soft-landing-economy-means-data-to-look-at> (Accessed: 22 August 2024)

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