FX Daily: Bank of Japan's slow move to the exit keeps JPY soft

USD/JPY is higher in Europe after the BoJ made the lightest of tweaks to its Yield Curve Control policy. At the same time, US Treasuries are slightly better bid as the Treasury announced a smaller borrowing requirement in the fourth quarter. Today's highlights include the US Employment Cost Index and 3Q GDP in the eurozone, probably keeping the dollar bid

USD: Steady near the highs

The dollar continues to trade on the firm side, with little to challenge it as yet. Weak PMIs in China overnight hardly make the case for redirecting portfolio flows to Asia at the moment, while the Bank of Japan meeting (see below) once again left yen bulls empty-handed. At the same time, the third-quarter GDP releases in Europe add to the sense of stagnation/recession over there. Additionally, the geopolitical background remains dollar positive, where any threat of escalation in the Middle East and what it could do to oil prices remains a dollar positive. In its latest commodity outlook, the World Bank thinks Brent crude could trade to $150/bl under its most disrupted scenario.

We have also seen the US Treasury announce its borrowing requirement for the fourth quarter. This has surprised a little, coming in at $776bn versus a projection of $852bn made in August. Better receipts have helped here. The focus now switches to the refunding mix announced tomorrow and whether the US Treasury wants to stuff an increasing share of the issuance into Treasury bills as a means to protect the long end. We see tomorrow's refunding announcement still as an important event risk for the bond market.

For today, the US calendar contains the third-quarter Employment Cost Index (ECI), one of the Federal Reserve's preferred measures for wage inflation and productivity. Consensus expects a modest 1.0% quarter-on-quarter. Any upside surprise would add to the Fed's current hawkish stance and the higher-for-longer narrative – a dollar positive. We will also see the Conference Board's measure of consumer confidence for October. This is expected to dip as presumably higher interest rates and the repaying of student loans start to weigh. Let's see whether investors want to laser-focus on consumer data since this community has driven the incredible third-quarter GDP figures.

Expect DXY to continue trading in the middle of a 105.35-107.35 range - with upside risks from the ECI data and downside risks from the confidence data.

Chris Turner

EUR: Softer rate profile weighs

Eurozone two-year swap rates have fallen close to 25bp over the last couple of weeks as data and dovish commentary feed the narrative that the ECB is done tightening. Today's data should support those themes, where eurozone third-quarter GDP should come in flat quarter-on-quarter and flash October CPIs should show further improvement. Headline and core CPI are expected to fall to 3.1% and 4.2% year-on-year from 4.3% and 4.5% respectively.

Softer eurozone swap rates have seen the two-year EUR:USD swap differential widen out again and provide a headwind to any EUR/USD recovery. Unless US consumer confidence falls sharply, we doubt investors will want to chase EUR/USD through intraday resistance at 1.0630/40, especially ahead of tomorrow's FOMC meeting.

Chris Turner

JPY: The BoJ's in no rush to exit YCC

USD/JPY is trading above 150 again as the Bank of Japan once again disappoints expectations of an exit from its Yield Curve Control (YCC) strategy. Accompanying today's release was this diagram showing how 1% in the 10-year JGB yield is no longer a fat red line (hard cap) but now becomes a reference rate around which the BoJ will be 'nimbly conducting market operations'. One gets the sense from the BoJ that it is wary of JGB yields spiking, and that is why it is acting so very carefully here. At the same time, the change in inflation forecasts was insufficient to support views of an exit to YCC policy. CPI ex food – which is the BoJ's target – is still forecast at 1.7% in FY25 - i.e., not above 2% in a stable manner.

We thought today we might also see FX intervention figures for October. These do not seem to have been released yet. All in all, however, today's BoJ meeting has not triggered the reset on how we view the yen and the risk is now that USD/JPY pushes ahead to 152 and prompts the central bank into aggressive FX intervention.

Chris Turner

CEE: Inflation as the first trigger for repricing in Poland

This morning, we have the first estimate of third-quarter GDP in the Czech Republic, the last hard number before Thursday's Czech National Bank (CNB) meeting. Unfortunately, the first estimate offers no detail and has proven not to be very reliable of late given the magnitude of later revisions. In Poland, October inflation will be released later. Our Warsaw team expects a further drop from 8.2% to 6.9% YoY, above market expectations, mainly due to the month-on-month rise in food prices.

EUR/CZK dipped well below 24.60 for the first time in two weeks, a few days before the CNB meeting. As we mention in our CNB preview, we expect EUR/CZK to trade lower into Thursday's central bank meeting due to a better relationship between CZK versus EUR rates over the past week. However, we see no reason to go below 24.50 EUR/CZK at the moment. On the other hand, if the CNB delivers a rate cut (which is our base case scenario), we see EUR/CZK in the 24.80-25.00 range by the end of the week. Also, in our view, the lower EUR/CZK increases the chance of a rate cut on Thursday as an important indicator for CNB these days and makes the market reaction to the CNB decision more asymmetric in the direction of larger CZK depreciation in case of a rate cut being delivered.

The zloty has remained surprisingly stable over the past two weeks. However, the National Bank of Poland is scheduled to meet next week and today's inflation number is likely to be the most important number before then. The market is currently pricing in a more than 25bp move for the next meeting and expects to deliver around a 150bp rate cut within a year. In our view, these expectations are too dovish and today's higher-than-expected inflation could be the first trigger for an upward repricing of the short end of the curve, which should be supportive for PLN to test 4.420 EUR/PLN again.

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