

FX Daily: Between the Fed and a hard place

It is a big day for financial markets. The US June jobs numbers are released at a time when the market is sinking its teeth into a Fed tightening cycle. Yet in other parts of the world, the resurgence in Covid-19 in countries with low vaccination rates is starting to cause concern. FX markets have to navigate this middle path and a slightly softer NFP might help.



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⬇️ USD: Softer than expected NFP can see the \$ hand back some recent gains.

It seems the market is firmly sinking its teeth into the Fed tightening story. December 2022 Eurodollar futures have recovered none of the losses suffered post the June 16th FOMC meeting. And our bond strategy colleagues point out that the 2s-5s-10s butterfly in the US Treasury market (5-year yields relative to 2s and 10s) has pushed up to the highest levels since summer 2018 as the conviction of a Fed tightening cycle grows. Consistent with this, the DXY is extending the rally off the lows in May.

So what are the implications for FX markets from today's NFP? It certainly seems that the market will have heightened sensitivity to the number since the Fed will be using NFP in its benchmarking of whether 'substantial progress' has been achieved in the recovery to justify tapering asset purchases. Consensus for today's June NFP has crept up to 720k today from 600k on Monday, with a slightly firmer than expected ADP figure helping that adjustment - even if the relationship between ADP and NFP is at best tenuous.

Our team looks for a lower than expected NFP number today in the 550-600k region. And as Francesco Pesole [points out](#), the six NFP releases seen so far this year have had a disproportionately negative impact on the dollar (4 of the 6 NFP releases missing consensus) and a positive impact on equities. Assuming that the NFP does indeed miss expectations again as labour supply issues again dominate, then we would expect the dollar to fall against the high beta currencies, such as NOK, AUD, and NZD in the G10 space and particularly MXN (see below) in the EM space.

Under such a scenario, the heavily European weighted DXY could correct to something like the 91.75 area as the numbers would feed into a patient Fed story. That is our preference. Should NFP come in at one million or higher, expect another big leg higher in the dollar and naturally high beta under-performing - in what could be a little more challenging environment for equity markets.

➔ EUR: Will today define the summer range?

Today's NFP data will probably play a big role in determining whether EUR/USD moves back into a summer range - e.g. a soft NFP number today firming up the 1.1835/45 as the low end of the range for the summer - or sees broad dollar gains extend. The latter would make the case for a retest of the March low at 1.1700.

Some customers we speak to see EUR/USD as good value down here ahead of what should be a pick-up in hard Eurozone activity data through 3Q21 and rising inflation - the latter questioning the ECB's super-dovish settings at its next meeting September 9th. Thus a EUR/USD decline to 1.1700 is not a given.

Also, today expect large option expiries to make their mark at 16CET. We see some large option expiries all the way from 1.1750 to 1.1950 today.

With the dollar story will still be largely determined by NFP, we still value in EUR-funded carry trades. Dmitry Dolgin yesterday released a [big update](#) on the Russian economy, revising GDP growth to 3.8% from 2.5% and making a call for a 75bp CBR hike to 6.25% on July 23rd. The recent bounce in EUR/RUB may well stall in the 87.00/87.50 area, before we see a break under 86.00 later this month.

➔ GBP: Bailey pulls the rug from Sterling

GBP's recent bout of out-performance faltered yesterday as BoE Governor Bailey said that the BoE should not over-react to the inflation spike. Unlike US interest rate futures markets, GBP markets is in the process of handing back the hawkish pricing seen in late June. Indeed, the market had been optimistic in pricing the first 10bp BoE rate hike in May 22.

GBP looks a little vulnerable to a further BoE re-pricing short term and EUR/GBP could see a decent rally if resistance break at 0.8610/15.

MXN: Huge remittances still coming in

The June NFP data will clearly define the near-term trading tone, but one currency that should continue out-performing should be the MXN. One of the more direct benefits of its border with the U.S. is the level of remittances that are being sent home. Data for May was released yesterday and registered a new monthly record of \$4.5bn. Year-to-date that is \$19.2bn coming into Mexico from overseas workers - as those in the US no doubt take full advantage of the opportunities afforded by the large fiscal stimulus.

The MXN is also backed up by last month's surprise Banxico hike - suggesting Banxico would take no risks with the summer spike in inflation and wanting to take control of inflation expectations that were drifting away from Banxico's 3% target.

Clearly, MXN is a high-beta currency and will be at the forefront of an FX adjustment to any deviation in NFP from consensus. Yet any intra-day MXN sell-off may well be limited to the 20.20/25 area in USD/MXN and this summer we would certainly favour a return to the 19.70, if not 19.50 area.

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