

FX Daily: Can softer US data slow the carry trade unwind?

Sunday's landslide win for the ruling party in Mexico and what it means for its policy agenda has sparked a 5% sell-off in the peso and upturned FX carry trade strategies as far afield as Hungary, Turkey, and India. Yet some softer US data could restore calm. Look out for rate meetings in Canada and Poland today, where a cut in the former could also help



📉 USD: Dollar caught in the crossfire of carry trade unwind

Our US economist, James Knightley, had an [excellent call](#) on a weaker US JOLTS job opening figure yesterday, yet the dollar did not sell off as we expected. That was because yesterday proved a further day of carry trade unwinding. It felt like a chain reaction was occurring where deeply and long-held positions in the Mexican peso continued to be unwound on uncertainty over constitutional reforms, and then the peso sell-off was exacerbated from the yen-funding side when reports suggested the Bank of Japan would cut its JGB buying plan (effectively tightening policy) at next week's meeting. Given that long MXN/JPY had been one of the most widely held - and profitable - carry trade strategies, this cross was always going to bear the brunt of the carry trade unwind. MXN/JPY has fallen 8% this week. 'Up the stairs and down the elevator shaft' as they say.

The generalised rise in EMFX volatility and consequent rising Value-At-Risk (VAR) has prompted de-leveraging in carry around the world. The popular Indian rupee (INR) was also hit when the ruling BJP party won far fewer seats than expected in the general election. And the very popular Turkish lira - which had seen \$65bn of inflows over the last two months according to the Finance Minister - was hit as well. On the funding side, the yen, the Swiss franc and the offshore Chinese renminbi (CNH) all outperformed.

Where do we go from here? From what we can see the external environment does not look too bad. Consumer and business confidence readings outside of the US are slowly picking up. And US data is slowly softening - including yesterday's JOLTS data showing a US labour market coming back into much better balance. This is allowing US yields to edge lower. And with the Mexican finance minister feeling the need to hold an emergency meeting to calm investors yesterday, we doubt there is enough bad news out there to keep one-week USD/MXN implied volatility trading above 20% for much longer.

We'll be focusing on two factors today that could calm conditions. The first is whether the Bank of Canada cuts interest rates at 15:45 CET today. [We think it will](#). A rate cut is only 83% priced today, so should it occur we can see Canadian interest rates dropping and potentially dragging US interest rates with them - that occasionally happens. Then at 16:00 CET, we will be focusing on the US ISM Services index. This has moved markets in the past. Consensus is expecting a bounce back from contractionary territory to 51. A sub-consensus reading can keep the US yields and the dollar on the soft side and provide some support to the risk/carry environment.

Our bias this week remains for a lower DXY. Expect resistance at 104.35/55 to cap any intra-day strength and we look for strong follow-through on the downside when support at 104.00 finally breaks.

Chris Turner

EUR: Waiting on the ECB

As above, it also looked like EUR/USD was caught in the cross-fire of the carry trade unwind, where EUR/JPY selling prevented EUR/USD from rallying on lower US yields yesterday. A neutral range for EUR/USD today is something like 1.0850-1.0900, but given the downside risk to US rates this week - plus the upside risk to Euro rates at tomorrow's European Central Bank meeting - we retain an upside bias for EUR/USD. Please see our [ECB cheat sheet](#) for more details on why we think EUR/USD can trade a little higher on the ECB event risk.

Chris Turner

JPY: On the turn?

Yesterday's spike in volatility has helped the yen. Local officials think their \$62bn of FX sales last month have helped inject some more two-way risk into USD/JPY - which it has. But it will take quite a lot to turn the USD/JPY bull trend around. ING's view remains that a turn will have to be driven from the Fed/US rates/dollar side rather than the BoJ/yen rates/JPY side. However, our call is that US rates come lower this summer ahead of the Fed's first cut in September and USD/JPY ends the year somewhere in the 140/145 range.

155-158 seems to be the near-term neutral range for USD/JPY and Friday's US jobs report, plus

next week's FOMC and BoJ meetings. will likely be the catalysts for this range break-out.

Chris Turner

➔ CEE: Zloty surprises but the timing is on the Polish side

Wednesday should be the quietest day of the week within the region. This morning we will see retail data in the Czech Republic for April, which we think should be more on the stronger side, following strong March data. Later today we will see the National Bank of Poland (NBP) decision. In line with expectations, we do not expect any rate changes. Therefore, the decision should garner little attention and the spotlight will be more on the statement and especially tomorrow's press conference.

FX markets in the CEE region yesterday entered another leg of sell-offs following the EM trend. While the Czech koruna again showed surprising resilience, Poland's zloty and Hungary's forint were hit hard. After [stronger-than-expected](#) wage data in the Czech Republic yesterday, the slowdown in the cutting pace seems to be a done deal and the hawkish Czech National Bank (CNB) should keep EUR/CZK at current levels even if the negative EM trend continues, in our view. Yesterday's paying flow at the short end of the curve adds the needed support in a negative global environment, in our view.

EUR/HUF broke 392, the highest level since late April. Although we remain rather negative on HUF, it seems to us that the main reason - the gap between rates and FX - is closed now and HUF should start to find some ground.

EUR/PLN is the main surprise for us this week, having likely hit a positioning reversal after touching 4.250 last week. PLN is the biggest and most stable long trade in the EM space this year but some longs seem to have been pushed out of the market for now. However, timing is in the PLN's favour with the NBP meeting today and press conference tomorrow. That should bring a regular hawkish dose. Still strong fundamentals are there and the NBP is the only central bank in the region where we don't expect any rate cuts this year. Weaker PLN levels look attractive to us for the days ahead with EUR/PLN heading back towards 4.270-280 if EM sentiment calms down.

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