FX Daily: DXY closing in on year's high ahead of Fed

The relentless stream of above-expected US inflation data continues. Yesterday it was the turn of the Employment Cost Index to surprise on the upside. Higher US rates have sent one measure of the trade-weighted dollar - the DXY - to the year's high. The prospect of a hawkish Fed tonight and potentially an equity sell-off will keep the dollar bid today

USD: An uncomfortable press conference for Powell

Another day and another above-consensus US inflation release. Yesterday it was the turn of the 1Q24 Employment Cost Index to surprise on the upside and return to levels last seen a year ago. Interestingly, it seems like a lot of the rise was driven by compensation in the public sector - a topic that touches on what the next US administration will do with the 2025 expiration of the Tax Cut and Jobs Act (TCJA). The high 1.2% quarter-on-quarter ECI figure has now seen the pricing of this year's Federal Reserve easing cycle narrow to just 29bp. Two-year US swap rates are closing in on the cyclical highs seen last October. And the late 2023 disinflation story feels like a dream.

It will be in this context the FOMC releases its statement at 2000CET today and Fed Chair Jerome Powell will hold a press conference at 2030CET. As we note in our Fed preview, the dollar has ended the day lower after the last three FOMC meetings. Today, however, Jerome Powell will have to acknowledge that US price trends have reversed higher, activity is holding up well and that any easing this year will have to be delayed. And at the moment it is hard to argue against the market pricing out the one last 2024 Fed cut at some stage soon.

A less dovish Chair Powell today can see US rates staying on the firm side. And market analysts note that option pricing for the S&P 500 index is warning that equities could see their biggest single-day move in a year. As we have noted over recent months, rising equity markets have prevented the dollar from rallying as much as yield differentials would suggest. An equity sell-off on the back of the higher-for-longer Fed rate story should therefore prove a clean dollar bull story - especially against those currency pairs most correlated with equities such as the Australian and Canadian dollars. USD/CAD could retest the recent high at 1.3845 under this scenario.

With much of Europe on holiday today, we are not sure US data released before the FOMC will have much impact on markets. We note, however, the big divergence between soft confidence data and strong hard US data. For example, it is not clear whether a soft US manufacturing ISM will move markets much today. We are interested in today's job opening, JOLTS, data. Here, any sharp decline - and also a decline in the quit rate - would suggest that excess labour demand is abating. This could prove a dollar negative on another day - but for today we think the FOMC will dominate.

DXY is now very close to this year's 106.52 high. And last October's high is barely a per cent away. The oft-cited phrase of the dollar being 'our currency, your problem' remains more apt than ever.

Chris Turner

EUR: Better eurozone activity numbers aren't helping

The eurozone printed some unexpectedly welcome 1Q24 GDP numbers yesterday. On another day, EUR/USD gains could have proved sustainable. Yet the release of the strong US ECI data dominated.

Most of Europe is closed for the Labour Day holiday today, so FX trading conditions will be very thin and dominated by events on the far side of the Atlantic. We could see EUR/USD trying to rally back to 1.0700 were US ISM manufacturing or the JOLTS data to surprise on the downside, but we would expect EUR/USD to turn back offered ahead of tonight's FOMC.

Anything considered a 'hawkish pivot' by Chair Powell tonight could easily see EUR/USD press 1.0600 amidst a sell-off in equities.

Chris Turner

JPY: Reports suggest intervention on the high side

Reports emerged yesterday that the Bank of Japan's intervention on Monday could have been towards the high side of expectations at JPY5.5tn or around $34bn. This is based on calculations from the BoJ's current account balances and the net drain of yen funds as FX operations were settled. As Francesco Pesole discussed yesterday, this will be part of a new campaign for Japanese policymakers as they seek to break the one-way cycle for the yen. However, Japanese policymakers are only too aware they are fighting a powerful dollar bull trend and that is why we doubt there will be any 'line in the sand' considerations for Tokyo.

If the Fed is hawkish tonight, USD/JPY could easily creep back to the 158.50/159.00 level. Perhaps more support for the yen could come from a broad risk-off move post-Fed. A sharp equity correction and rising volatility would prompt VAR-driven deleveraging of the carry trade and support the yen. Crosses like AUD/JPY and MXN/JPY would again be most vulnerable under such a scenario.

Chris Turner

CLP: Peso should be doing better

Copper recently moved above $10,000/mt. Chile's terms of trade are surging. Why is Chile's peso not doing better? We think that the peso's price action has been pretty weak and it should have performed better - albeit acknowledging the strong dollar environment. This price action is no doubt worrying to local policymakers who have used the brief window of US disinflation to slash the local policy rate from 11.25% to 6.50% over the last nine months.

The peso's real rate protection is now quite lean by Latam standards and we are worried that a reversal in copper prices and Chile's low FX reserves can see USD/CLP pressing the 990/1000 area this quarter.

Chris Turner

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com