FX Daily: Fed confirms it checked rates in USD/JPY

The release of the January FOMC minutes last night confirmed that the New York Fed did check USD/JPY rates on behalf of the US Treasury last month, adding to the view that Washington wouldn't mind a weaker USD. The other takeaway from the minutes was that most of the Fed needs to see lower inflation before cutting rates again. The dollar rally looks stretched

The Federal Reserve has confirmed it did check USD/JPY rates on behalf of the US Treasury last month

USD: Dollar rally unlikely to last

The dollar got a bid from the release of the FOMC minutes last night. Newswires latched onto the view that several participants would prefer a two-sided description of the Federal Reserve's future rate intentions to reflect that it could actually hike if inflation remained at above-target levels. However, the broad takeaway from the minutes seemed to be: a) downside risks to employment had lessened, b) activity was seen as relatively strong and c) that an expected softening in inflation could pave the way for further rate cuts later in the year. Our takeaway is that the emphasis will now shift from the labour market back to the inflation readings. These need to fall to validate the two rate cuts still priced into money markets this year. We think that will be the case and that the Fed will indeed cut twice.

What also stood out to us in the minutes was the Fed's full disclosure on the USD/JPY rate check. The minutes confirmed that the New York Fed did check rates in USD/JPY on behalf of the US Treasury and in its role as the fiscal agent of the US. This likely happened at 5:00pm London time on Friday, 23rd January, when USD/JPY was trading around 157. Something like this is extremely rare in foreign exchange markets and is a sign of a more activist White House when it comes to FX. The move was clearly designed to deliver maximum impact and reflects the shared desire from both Washington and Tokyo that USD/JPY does not sustain a move through 160. With both parties on side and with monetary policy moving in the right direction (the Fed cutting, the Bank of Japan hiking), we think there will now be good interest to sell USD/JPY in the 156/158 area from the asset management community.

For today, the focus will be on initial claims and the December trade surplus. US President Donald Trump posted on social media last night that the trade deficit had narrowed 78% last year and that the US could be running trade surpluses this year. A narrower-than-expected December trade deficit today would add to expectations of a decent 4Q25 GDP figure tomorrow and could provide the dollar with a little short-term support.

DXY could drift towards the 98.00 area, but we think the market's sell dollar rally mentality remains.

Chris Turner

EUR: European outperformance

A look at year-to-date equity benchmark performance shows European bourses handily outperforming those of the US. In dollar terms, the Eurostoxx 50 has performed nearly twice as well as the S&P 500. The thesis of rotation out of the US and into Europe has yet to be fully backed up by US TIC data, however. December saw continued strong foreign demand for US equities from both the private sector ($65bn) and the official sector ($31bn). And US residents bought around $15bn of foreign equities. However, we get to see eurozone portfolio inflow data with the release of the Balance of Payments data. These have been strong and have been maintaining the trade-weighted euro at high levels. If the dollar weakens any further, we can see FX markets dominating short-term interest rate markets and a European Central Bank rate cut being priced with greater conviction.

We do not see those FOMC minutes justifying EUR/USD trading substantially under 1.18. And we remain happy with a forecast that EUR/USD ends March near 1.19.

Chris Turner

CHF: Terribly strong

The Swiss franc remains incredibly strong. Whether the inflows are a function of the dollar de-basement trade or positioning for a US strike on Iran remains unclear. What is clear, however, is that the Swiss National Bank's tools to fight this currency strength are limited. We had not been forecasting EUR/CHF hitting such low levels, but until the building US armada turns away from the Middle East, it looks like EUR/CHF will stay pressured. The SNB has said that it really does not want to take the policy rate negative again, but as this pressure remains on EUR/CHF, it would not be a surprise for the market to price in one full 25bp rate cut from the SNB over the next year. Currently -12bp is priced.

Chris Turner

CEE: Polish data confirms stable growth and easing labour market

The region continues to trade sleepily this week, and it is hard to see a significant change in the local story today. Poland will publish monthly economic figures for January. December's industrial production reading was well above market expectations, but this performance is unlikely to be repeated in January. At the same time, wage growth in enterprises surprised to the upside in December, but the stronger figures were largely attributable to annual bonus payments in certain sectors. Overall, we expect rather stable, solid growth with a gradually easing labour market in Poland, which should allow for further National Bank of Poland rate cuts – probably already at the March meeting, unless today's numbers surprise significantly.

Although the zloty has been trying to rejoin the interest rate differential in recent weeks, the relationship is not very strong yet. At the same time, the global story does not suggest much higher volatility this week. Therefore, EUR/PLN is likely to remain in the same range of 4.200-230.

Frantisek Taborsky

Author

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

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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