FX Daily: Fed patience provides breathing room for risk assets

The market reaction to last night's FOMC statement was a mildly positive one, as Chair Powell's acknowledgement that the Fed could afford to be a little patient saw US yields and the dollar soften slightly. Today, all eyes will be on the ECB, where a 25bp hike is widely expected along with the door being left open for another hike in September

USD: A little early to chase the dollar lower

In the end, the dollar tracked US yields and marginally softened after yesterday's FOMC rate decision and press conference. Fed Chair Jerome Powell delivered another credible performance, and it seemed that markets – perhaps because of positioning – latched onto comments that the Fed "could afford to be a little patient" as a result of all the tightening implemented so far. US two-year yields edged some 7-8 bps lower, and December 2024 futures contracts priced Fed Funds some eight ticks lower at 4.07%, embracing five 25bp cuts in 2024.

One of the clearest messages coming through from the press conference was that Chair Powell felt the Fed was "not in an environment where we want to provide a lot of forward guidance". In other words: listen to the data, not the Fed. On that subject, he highlighted that by the time of the next meeting on September 20th, the Fed would have two new CPI reports, two new job reports, and the Employment Cost Index (which will be released tomorrow).

While the dollar is a little lower today post-Fed, we would not chase the move just yet and prefer to take our cue from the data, starting with tomorrow's ECI. As we discussed in our FOMC review, the carry trade environment will still be popular and with overnight deposit rates at 5.25%, the dollar is clearly not a funding currency.

Beyond the ECB meeting today, the US calendar should see some downward revisions to second quarter GDP, durable goods orders, and initial jobless claims. Of these, claims might be the most important given the ongoing need to see tight conditions ease in the US labour market.

Barring any hawkish surprise from the ECB today, DXY should trade within a 100.60-101.20 range.

Chris Turner

EUR: Hawkish ECB, but will we hear more about QT?

Here is our full European Central Bank (ECB) preview and also a look at some of the key variables that could drive a reaction in eurozone FX and rates markets. The challenge now for the ECB is to deliver a hawkish message – a 25bp hike and the promise of more still to come – while balancing the risks that its growth forecasts are too high. One common pushback from customers against our bullish EUR/USD view is that ECB hawkishness will crumble early and not allow US and eurozone rate differentials to narrow as we expect.

Assuming the ECB does maintain market expectations that the deposit rate (now 3.50%) will be close to 4.00% by the end of the year, what else could we see? One intriguing idea is that the hawks, in exchange for backing off from subsequent rate hikes, will be given something on quantitative tightening. Currently, re-investments of the APP scheme ended last month. PEPP reinvestments are targeted to continue until the end of 2024. Could PEPP reinvestments be cut shorter, or could the discussion move onto outright asset sales – moves that might upset both peripheral government bond markets and European credit markets? The market reaction might be tricky, but presumably, EUR/CHF could stay under pressure should this be the case.

We do not have a strong conviction call on EUR/USD today but would say 1.1150 looks good intra-day resistance and 1.1000/1020 is now the lower end of the near-term trading range.

Chris Turner

JPY: Prepping for the BoJ

A lot of interest is building in tomorrow's Bank of Japan meeting. Please see our full preview here. Most expect no change in the BoJ's Yield Curve Control policy, largely on the view that the new BoJ Governor, Kazuo Ueda, would not want to undermine a clear communication policy by springing a surprise.

The FX market is a little nervous, however. The one-week risk reversal – the price for a USD/JPY put option over an equivalent USD/JPY call – has traded out to an extreme 4.1% in favour of USD/JPY puts. This is the most extreme skew to USD/JPY puts since March 2020. We will know a lot more by this time tomorrow, but as our colleague Min Joo Kang notes in her preview, the chances of a YCC adjustment are not negligible and investors risk being too complacent here. For reference, USD/JPY fell seven big figures (albeit in thin conditions) when the BoJ surprised by widening their JGB yield target band last December.

Chris Turner

CEE: Good news for region

The regional calendar is empty today and the main topic will of course be the aftermath of yesterday's Fed decision and today's ECB meeting. Higher EUR/USD as a result of yesterday's Fed decision is clearly good news for CEE FX. In addition, yesterday's closing of equity markets in Europe suggests a renewed improvement in sentiment. And the latest good news from yesterday is the steep drop in gas prices after the rise in the last two weeks. The gas storage picture looks better than at the same time last year and, most importantly, consumption resulting from heat waves in Europe has finally fallen. The risk of course is today's reassessment of yesterday's news, but for now, everything looks green for the CEE region.

Given the Hungarian forint's greatest sensitivity to gas prices, we see the most room for recovery here again. Already yesterday's close showed a jump from 384.1 to 381.6 and we expect that a move below 378 should not be a big problem today. The Czech koruna should also see a strengthening due to the same reasons. Technically, we could still hear some CNB statements today but the blackout period starts later today. However, thanks to the above-mentioned conditions, we could see EUR/CZK back below 24.0 today.

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