

FX Daily: FOMC minutes suggest Fed is in no rush

In a quiet week for the US events calendar, last night's release of the January FOMC meeting minutes served as a reminder that the Fed is in no rush to cut rates. That was not much of a surprise to markets which continue to price around 90bp of Fed easing this year. For today, the focus will be on the European PMIs and the rate meeting in Turkey



➔ EUR: PMIs and ECB minutes in focus

EUR/USD has been doing a little better, largely on the back of a better investment environment. Two-year EUR:USD swap differentials have been moving nowhere fast and, again, very low levels of traded volatility warn against chasing breakouts.

The highlight of today's session will be the release of European PMIs. As we know, these took a turn for the worse last summer/autumn and took a chunk out of the euro. A modest uptick here is expected today, but unless the eurozone composite PMI can make a run at the 50 level, we doubt EUR/USD will get too much joy from the release. Equally, we doubt that the release of the European Central Bank (ECB) minutes will move the needle on market pricing of around 100bp in

ECB rate cuts this year. For reference, our economists are only looking for 75bp of easing.

EUR/USD is currently breaking above short-term resistance and looks like it wants to test the 1.0865/1.0900 area, but the case for any higher levels is yet to be made.

Elsewhere in the EMEA space, we have a Central Bank of Turkey (CBT) meeting. Our local economist, Muhammet Mercan, [expects rates to remain unchanged](#) at 45% and remain so until the fourth quarter. Looking at EM currency performance this year we note that the Turkish lira leads the pack in delivering 3% total return gains against the dollar this year. The only other two EM currencies in positive territory are the Indian rupee and the Mexican peso, both at +1.4% year-to-date versus the dollar on a total return basis. We see these trends continuing for the time being.

Chris Turner

➔ USD: Fed needs more evidence

Reading through the [FOMC minutes](#) last night, the message seemed reasonably clear: significant progress has been made on inflation, the tightening cycle has peaked, but "most participants noted the risks of moving too quickly to ease the stance of policy and emphasised the importance of carefully assessing incoming data in judging whether inflation is moving down sustainably to 2 percent". Consistent with Fed Chair Jerome Powell's press conference at the time, the word 'confidence' was sprinkled liberally through the minutes, indicating that the Fed needs to be sure that inflationary risks have been extinguished before cutting rates back to some kind of neutral level – probably near 3%.

Our game plan here sees the dollar staying bid for the next couple of weeks - we should get a strong January core PCE release on February 29th - and then turning lower in March on what should be a softer payrolls report and a softer February CPI figure. In early March we could also hear of some fresh China stimulus which would be a boon to the Rest of the World currencies.

For today, we note the slightly better investment environment propelled by stellar earnings from Nvidia. We note here as well that Japan and Korea have high-end chip industries too and suspect that the yen and won will be a lot stronger later this year. Barring a big jump in US initial claims today expect DXY to trade in tight/slightly softer ranges and the bigger impetus to come out of Europe today.

DXY is currently on support at 103.80 and were European PMIs to surprise on the upside, 103.30 could be the risk today.

Chris Turner

➔ JPY: Under-valued, but weighed by the carry trade

G10 FX performance this year has largely fallen along carry trade lines. Some of the better performers, like the Canadian dollar and the pound, have the highest risk-adjusted carry on offer. And the stand-out funding currency, the yen, is the worst performer at -6% year-to-date versus the dollar. We cannot see the low volatility/carry friendly environment turning anytime soon, suggesting the yen stays weak.

However, we now think that the yen is close to 15% under-valued on our medium-term fair value models. Helping the yen's valuation – if not the its spot value – is the turn in the trade account.

Here what was a JPY 2.5trn trade deficit during the energy shock of 2022 has now turned back into a trade surplus.

A substantial turn lower in the USD/JPY probably requires a turn in the broad dollar trend, something we look for late in the second quarter. Should USD/JPY make it into the 155/160 area beforehand, we would see that as a good medium-term level for corporates to ratchet higher their USD receivables/JPY payables hedging plans.

Chris Turner

➔ CAD: Seemingly immune to softening domestic story

Soft global equities momentum and sub-consensus Canadian CPI numbers would normally be associated with a weakening Canadian dollar. Instead, the loonie's dip versus USD has been smaller than any other G10 currency since the start of the week. The reason is once again to be searched in CAD's correlation with US data sentiment. The loonie has traded more in line with data out of the US than data/central bank developments in Canada on numerous occasions in the past months.

It is now clear that markets see a very direct link between Bank of Canada and Fed policy trajectory, and the pro-cyclical trades induced by softer US data often rewarded other high-beta G10 currencies (NOK, SEK, AUD, NZD) more than CAD. We suspect today's retail sales out of Canada won't impact CAD as much as the upcoming US releases, which may remain the case as long as the USD retains its strength. Ultimately, a USD decline and CAD's rate attractiveness should send the pair back to 1.30 by the second half of this year, but we still think the market is underpricing BoC easing, and CAD looks less attractive than its oil-peer NOK this year also from a valuation perspective.

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