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FX Daily: High alert on JPY intervention

Softer US jobs data has weakened the dollar, but we do not see this as sufficient to extend USD losses on its own. We look for near-term stabilisation in DXY. Thin liquidity around the US holiday today and Monday increases the risk of JPY intervention, with an initial round that may already have occurred yesterday morning

With US holidays thinning liquidity today and on Monday, the risk of further intervention remains elevated despite the recent correction lower in USD/JPY

USD: Poor jobs report not enough to bring dollar much lower

There aren't many silver linings in yesterday's US jobs report. A still respectable 57k payroll gain is more than offset by 74k of downward revisions to the previous two months. Hiring also remains heavily concentrated in private education and healthcare, which added 69k jobs versus a modest 49k increase in total private payrolls. The 0.1ppt drop in unemployment to 4.2% was driven mainly by a lower participation rate, an unencouraging sign of worker disengagement.

Overall, the report makes it harder for markets to rebuild expectations of two Federal Reserve rate hikes. At the same time, it is not weak enough on its own to trigger significant dovish repricing. Despite yesterday's front-end correction, more than 25bp remains priced into the December contract, and markets can still hold on to expectations of at least one hike into the 14 July CPI release.

While the data supports our bearish USD view for the second half of the year, we do not see the greenback entering a sustained downtrend yet. Instead, DXY may stabilise in the 100.0-101.5 range over the coming weeks.

With US markets closed today for Independence Day, liquidity will be thinner, creating – as discussed below – an opening for potential Bank of Japan intervention.

Francesco Pesole

EUR: Lacking a bullish narrative

Price action in EUR/USD in the hours after the US jobs report highlights the lack of a convincing bullish narrative for the euro. That is largely explained by markets starting to doubt the ECB will hike again after all, with pricing for September at 11bp and for year-end at 17bp.

While ECB speakers have generally tried to hang on to a hawkish tone, President Christine Lagarde and others have conceded that the policy response may not need to be that aggressive from here. Lower-than-expected June CPI this week and oil prices staying stubbornly low mean that some second-round effects on core inflation may well be needed for the ECB to hike again.

The risks are that markets price out all ECB tightening before doing the same for Fed tightening. While the impact beyond the near term can still be a net positive for EUR/USD (which often responds asymmetrically stronger to the Fed), this dynamic argues against a fast return to 1.16-1.17 from here. We expect rallies to start getting tired beyond 1.150-1.153 in current conditions, and forecast a return above 1.16 only late in the summer.

Francesco Pesole

JPY: Markets pricing high intervention risk

USD/JPY saw downside volatility yesterday, even before the soft US jobs report briefly pushed the pair below 161.0. We cannot rule out that this initial move was driven by FX intervention.

With US holidays thinning liquidity today and on Monday, the risk of further intervention remains elevated despite the recent correction lower in USD/JPY. Japanese authorities tend to act around holidays and to spread operations over multiple days. Acting in the wake of a USD-negative event would also be consistent with their approach in 2024.

A sharp decline in USD/JPY one-week risk reversals points to a higher implied probability of imminent intervention. While softer US data improves near-term conditions for the yen, we believe more hawkish rate communication from the Bank of Japan is still needed to prevent a repeat of the rebound in USD/JPY seen after the April/May intervention round.

Francesco Pesole

TRY: Disinflation to revive rate-cut hopes while carry remains king

Turkey will release its June inflation data this morning. We expect monthly inflation to ease further to 0.8%, bringing annual inflation back onto a downward path at 31.9%, from 32.6% in May. The main drag should come from unprocessed food prices, helped by stronger agricultural output and favourable rainfall so far this year, while the sharp fall in oil prices should also ease pressure on energy inflation.

The Central Bank of Turkey has faced renewed inflation pressure since the start of the year. This was amplified by the US-Iran conflict, which left Turkey the most exposed country in the region to higher fuel prices. In this context, the improvement in global conditions is the key support for lower inflation, offering some welcome relief to the central bank.

The CBT recently removed the additional lira reserve requirement on FX deposits, previously set at 2.5% and introduced in 2023. This should release liquidity into the banking system, effectively easing monetary conditions. If today's data confirms that disinflation has resumed, the CBT could restart weekly repo auctions and bring the weighted average cost of funding closer to the 37% current policy rate level.

USD/TRY remains on a steady upward trajectory, but the central bank has been allowing the lira to weaken further over the past three months – between 1.50-1.75% per month, leaving slightly less carry on the table. Still, the lira remains the main FX carry trade in the EM space, and we have seen long positioning return essentially back to pre-US-Iran conflict levels. This reflects a return of confidence in the TRY market, which today's inflation figures should confirm and get the market back to pricing in rate cuts again.

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