

FX Daily: JPY correction – small, medium or massive?

The size of the correction in the yen is now the market's primary preoccupation. The unwinding of yen shorts is undoubtedly contributing to the global risk-off environment. There is certainly more unwinding to be done here and data/events over the next few days present further downside risk to USD/JPY. That risk today comes from the quarterly US PCE data



⬇️ USD: Risk off might be dollar negative

Markets are in a risk-off mood, where US earnings this week have failed to arrest the correction in tech stocks. The Nasdaq was off a large 3% yesterday and the Magnificent Seven is now down 12% from its highs earlier this month. In retrospect, buy-side investor surveys from late June proved telling in that they showed a buy-side fully committed to risk (cash levels very low), with the three most crowded trades being 1) Long the Magnificent Seven 2) Short China equities and 3) Long Gold. China's [surprise MLF rate cut overnight](#) might help Chinese equities to outperform in the short term and the broad unwinding of carry trades also means that USD/CNH is trading lower despite the rate cut.

We discuss USD/JPY in a little more detail below, but the overriding FX story is one of the low-yield funding currencies outperforming – i.e., the yen, the Chinese renminbi and the Swiss franc. The high yield and commodity currencies are underperforming; this group is also hit by the building view that central banks (primarily the Federal Reserve) might be keeping rates too restrictive for too long. Certainly, the views of former NY Fed President Bill Dudley [that the Fed should cut rates in July](#) got a lot of airtime in markets yesterday.

This brings us to today's US data. The focus will be on the second quarter GDP figure. This is expected to rise to 2.0% quarter-on-quarter annualised from 1.4% in the first quarter. More interest might be had in the second quarter core PCE price data. From this investors will be able to calculate tomorrow's release of the June core PCE number. That number is widely expected at 0.2% month-on-month, consistent with the Fed's 2% inflation target. Confirmation of such a number could see the short end of the US yield curve drop further as the market shifts to pricing in three rate cuts this year. Currently, the market fully prices a 25bp Fed cut in September and 63bp of cuts in total for this year.

We have a down arrow on the dollar today because we think it has been a beneficiary of the carry trade – and if today's focus is on lower US rates, then the dollar should come lower across the board.

DXY may well trade to the lower end of a 104.00 to 104.50 range.

Elsewhere, the Bank of Canada cut rates by 25bp yesterday, in line with expectations. [As discussed here](#), BoC Governor Tiff Macklem sent two dovish signals: a) he partially shifted the focus from inflation to growth risks as the BoC signalled more cuts ahead; b) he sounded relaxed on the widening BoC-Fed gap. That means that a cut in September (two weeks before the Fed) is possible should Canadian data continue to deteriorate

Chris Turner

➔ EUR: Euro proving a sideshow

Eurozone July PMI data was not particularly encouraging and showed manufacturing – particularly in Germany – dragging down composite PMI numbers. This will reinforce the European Central Bank's view that short-term economic risks lie to the downside. Expect more of the same today from the German Ifo reading, and also look out for ECB speakers Joachim Nagel at 1:00pm CET and Christine Lagarde at 5:00pm CET. It seems the direction of travel here is for two further ECB rate cuts in September and December.

In terms of rate differentials, we see scope for further narrowing in the EUR:USD two-year rate spread, which means EUR/USD could head back towards 1.0900 if the Fed easing narrative dominates today.

Yesterday, our FX Strategist Francesco Pesole [published an update](#) on the Norwegian krone and Swedish krona following the latest selloff. He identified several factors pointing to a rebound in both currencies, with NOK potentially having wider room for recovery.

Chris Turner

📈 JPY: Correction can extend

USD/JPY has now corrected 6% off its high. This has proved another successful intervention campaign for Japanese authorities. As we have said in this space before, we think the success of the intervention has had less to do with the size of the FX sales and more to do with the timing. As was the case in September/October 2022, Japanese FX intervention has been timed to coincide with a dovish reappraisal of Fed policy. Very clever.

While one can argue over what has been the main driver of this USD/JPY correction – intervention, US rates, tech stock correction, suggestions that a Trump administration would warrant a weaker dollar, Japanese politicians coalescing around views for a stronger yen – the heart of the issue has been stretched positioning. Speculative short yen futures positioning had recently hit the most extreme levels of the last 20 years and have plenty more scope to unwind. We have also made a back-of-the-envelope calculation that short yen futures positions built this year were done so at an average USD/JPY rate of 152.50. In aggregate, those positions are nearly underwater.

We think there could be some further unwinding to be done here. On one side, lower US short-dated rates could hurt USD/JPY. Remember that USD/JPY has been responsive to these. Equally, we're running into a Bank of Japan meeting next Wednesday where we think the market does not fully price risks of a 15bp rate hike from the BoJ and a cut in the BoJ's JGB buying plans.

We doubt investors will want to rebuild long USD/JPY positions over the next few days, and with a market still substantially short yen, the risk is that this USD/JPY correction extends to or just below 150. And one major beneficiary of the carry trade, the Mexican peso, looks quite vulnerable. Were the shake out in yen shorts not enough to hit the peso, it now also has to contend with Elon Musk threatening to stall \$10bn plans for investment in a gigafactory in Mexico. Add in Mexican political risks re-appearing in September and we are happy with our bearish MXN views presented in recent editions of [FX Talking](#).

Chris Turner

➡ CEE: Each to their own, driven by the central bank

The calendar in the CEE region today does not have much to offer. Markets, on the other hand, are seeing more interesting developments these days. EUR/HUF moved up quickly after Tuesday's National Bank of Hungary meeting. Yesterday, it almost hit the 394 level from our [NBH review](#) and we still believe this is the direction for the days ahead with a landing in the 395-400 range.

EUR/CZK, after grinding down in the previous week, saw a restart on Tuesday with a move back to 25.400. However, markets are starting to take notice of the Czech National Bank's hawkish comments preferring a 25bp rate cut and reducing the chances of a 50bp move. The CNB blackout period starts today and we think there is room for one more interview usually issued by Reuters. CZK rates bounced higher yesterday after the central bank's comments and we may likely see more today. We think yesterday's move here points to EUR/CZK at 25.300 and if we see paying flow today, the potential for a CZK rally is bigger. We believe that if the CNB opts for a 25bp rate cut at its meeting next week, EUR/CZK could return below 25.000.

EUR/PLN moved up almost to 4.300 yesterday but for now, we do not see much of a story here and instead more of a range move in the 4.280-300 area. However, next week we will see the key July inflation print. This will illustrate the effect of the removal of the government's energy

measures, which in turn will tell us more about the direction in the second half of the year and the accuracy of the National Bank of Poland's hawkish view.

Frantisek Taborsky

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

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.