

FX Daily: Moving to DEFCON2 on Japanese FX intervention

Yesterday's spike in USD/JPY through 130 prompted quite a reaction from Japan's Ministry of Finance. FX intervention seems a lot closer now, but will only serve to stabilise and not reverse a macro-driven trend. For today, the focus will be on European 1Q GDP and April CPI, plus some of the Fed's preferred price gauges. We also have a Russian rate meeting



➔ USD: Today's Employment Cost Index will be key

FX markets are slightly calmer today, helped by some stability in Chinese asset markets. The renminbi, a key agent in recent FX volatility, has firmed a little as China's Politburo has promised to do more to support growth. The sharp rally in the whole [USD/Asia FX complex over the last week](#) had contributed to broad strength in the dollar, although this trend now may be due a pause. Away from China's commitment to support growth, we have seen both Japanese and Korean authorities express 'extreme concern' over recent weakness in their currencies and an implicit readiness to act.

It feels like Japanese unilateral FX intervention is a lot closer - perhaps we are at [DEFCON2](#) in terms of readiness - and we are now close to witnessing Japan's first FX intervention [in over a decade](#). Such intervention could probably see several billion dollars sold (typically at a European or US open). However, the reasons for USD/JPY trading above 130 are well documented and any correction, say, to the 127/128 area will see plenty of fresh dollar buyers emerging.

For today though, the dollar focus is squarely on US price data. We will see the March release of one of the Fed's preferred price gauges - the PCE deflator. This is expected at a new cycle high of 6.7% year-on-year. Perhaps even more important is the quarterly Employment Cost Index (ECI) data, a key gauge of US productivity. A strong rise in the ECI is expected at 1.1% quarter-on-quarter. Assuming that is seen, expect pricing for the Fed tightening cycle to stay firm. Currently, the market prices the Fed Funds rate at 2.88% by the end of the year and currently sees the terminal Fed funds rate at 3.15% next year. The recent high in expectations was at 3.30%.

DXY may be due some consolidation under 104 given that technical indicators are registering some very overbought readings. Yet there will be lots of dollar buyers ready on dips and looking to position for a summer dollar rally as the Fed slams on the monetary brakes.

➔ EUR: Upside risks to April CPI

Our eurozone macro team sees upside risks to today's April eurozone CPI release, where consensus sits at 7.5% YoY for the headline reading and 3.2% for the core. An above consensus figure will no doubt draw out the ECB hawks. However, the eurozone money market already prices in 87bp of tightening this year - pricing which has done little to help the euro. And there is a case to be made that in the event of an abrupt shut-off in European gas, the ECB will struggle to deliver more than a 50bp rate hike - effectively normalising the deposit rate to zero. We will also have the first look at 1Q22 eurozone GDP data today - expected to deliver a modest expansion of 0.2% QoQ.

Having briefly dipped under 1.05 yesterday, EUR/USD has regained a little composure today. The international environment (stronger Asia) favours some consolidation in EUR/USD short term. That could mean a limited correction to 1.0560/70, with outside risk to 1.0650. But we will be reviewing our baseline scenario of a 1.05-1.10 range this year for a possible downgrade on the back of a Fed taking rates into restrictive territory and the challenges faced in Europe.

Elsewhere, we will see Polish April CPI today which is expected at 11.4% YoY. Our team sees upside risks to this number - a number which should cement expectations of a 100bp rate hike from the National Bank of Poland next week. EUR/PLN could correct back to the 4.62/63 area on the day - though events to the East will prevent it making much more progress to 4.50 - our target for when conditions settle.

➔ GBP: Overcooked?

Cable has come a long way very quickly and is now trying to reclaim the big 1.25 level. As we discuss in our [Bank of England preview piece](#), short term financial fair value models have gone a little awry, where yield curves and equity markets are now bigger drivers of sterling than rate differentials. In other words, it looks as though sterling is being traded more on growth prospects at the moment.

European FX could get a small lift today if eurozone CPI surprises on the upside and the ECB hawks come out in force. That could carry EUR/GBP back to 0.8450/60, but a stronger EUR/USD could

carry GBP/USD back to the 1.2570/2600 area on the day.

➔ RUB: Consensus expects a 200bp Russian rate cut today

The Russian central bank is widely expected to cut rates 200bp today to 15%. This will be a further reversal of the emergency 10% rate hike put in place after the rouble collapsed on western sanctions. The rate cut is expected now that USD/RUB is artificially trading very low at 72 - driven by no natural buyers (foreigners cannot sell Russian assets and Russian imports have collapsed) and continued selling of energy FX receipts.

In addition, the market will be interested to see whether the central bank eases any capital controls today in light of rouble strength. No change is expected on controls for foreigners but enforced FX sales for the Russian export community have recently been softened up. Any loosening on controls for domestics could see the rouble weaken on a sign that Russian authorities want a weaker rouble for budgetary purposes.

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