

FX Daily: Nowhere to hide, but in dollars

The US Treasury sell-off continues and it feels like something is about to break. Higher cross-market volatility and wider credit spreads very much favour conservative positioning - which in the current environment means holding dollars. Look for ISM Services and the ADP jobs figure in the US, while in Europe, investors await comments from ECB's Lagarde



📈 USD: No point catching a falling knife in the bond market

Global financial markets continue to be dominated by the sell-off in US Treasuries. The 10-year yield has traded up to 4.85% overnight in Asia. Bond strategists continue to point to the re-pricing of the multi-year Federal Reserve cycle as the main driver of this bond market sell-off. Here, the forward markets now price the low point for the Fed cycle - in two to three years' time - above 4.50%! This was priced at 3.68% at the start of September. Driving that re-pricing has been the relentless run of strong US data, of which yesterday's August JOLTS job opening data was the latest example. The data also lends support to hawkish Fed rhetoric. Today we will again hear (16:25 CET) from Fed hawk Michelle Bowman who earlier this week was calling for multiple further hikes. Today also sees the September ADP jobs report (a somewhat discredited release) and ISM Services data.

Back to the bond market and what it means for FX. We are starting to hear more about the 'term premium' in the US Treasury market and how it has turned positive for the first time since early 2021. Recall that the term premium represents the extra compensation investors need for holding a bond to account for things like inflation or fiscal risk. The US 10-year Treasury traded with a +100bp-+300bp term premium before the launch of the Fed's quantitative easing campaign in 2008/09. The term premium having just crossed back into positive territory now, one can see why

investors are reluctant to call a top in Treasury yields.

This sharply higher risk-free rate is unsettling markets around the world. Cross-market volatility is picking up sharply which will continue to prompt an unwind of carry trade strategies. Here, the carry trade's former darling - the Mexican peso - is getting hit hard. USD/MXN looks as though it could correct to the 18.50/70 area before the dust settles. An unwind of the carry trade will provide some natural support to the Japanese yen (more on that below) and continue to provide headwinds to other popular high-yield currencies in Latam (Brazil and Colombia), Europe (Hungary) and Asia (Indonesia). And wider credit spreads - e.g. the CDX high yield index heading back to March levels - warn of a sharper deterioration in equity markets. These moves will deliver more pain to struggling emerging markets, where Egypt looks on the verge of another large devaluation.

Clearly, there seems little reason to sell the dollar at present - perhaps only a shock drop in ISM services could weigh on the dollar today. 106.70 is now support for DXY and the direction of travel remains towards 108.

Chris Turner

➔ EUR: ECB may put up a fight

The European Central Bank's trade-weighted euro is about 3% off its highs in July. While European politicians may welcome a softer euro to help the export sector, presumably the ECB will not be welcoming these low levels of EUR/USD at a time when it is still battling inflation and oil prices are high. On the subject of oil, we could today see a large fall in US crude oil inventories - confirming that the oil market remains in deficit and possibly sending Brent higher again.

Market conditions may therefore prompt some slightly more hawkish rhetoric from the ECB. Here, President Christine Lagarde speaks at 10:00 CET today at a monetary policy conference. Given the market prices virtually no further tightening from the ECB, any hawkish remarks from her could provide a little support to the beleaguered EUR/USD. However, any gains above 1.05 look hard to sustain given the tough external environment and we can see EUR/USD trading to the soft side of a 1.04-1.06 range over the coming weeks.

Chris Turner

⬆️ JPY: Tokyo proves coy on intervention

There is much speculation over whether Japanese authorities intervened yesterday afternoon to sell USD/JPY. The flash crash from 150.15 to 147.30 had all the hallmarks of intervention, although Tokyo has failed to publicly confirm that it either 'checked rates' (a precursor to intervention) or indeed sold dollars. During last year's FX intervention campaign where the BoJ sold \$70bn through September and October, Tokyo was happy to confirm intervention and did so in a reasonably noisy way. Tokyo's silence now may indeed suggest they didn't intervene and the sharp sell-off could have possibly been caused by re-positioning after option barriers in USD/JPY were hit at 150.

As above, there are no signs that US Treasury yields are near a peak meaning that even if intervention took place, USD/JPY could still go higher. For example, last year's intervention started at 146 in September and did not stop USD/JPY trading to 152 in October. However, we would say that the difficult external environment and the unwind of the carry trade will give the yen some

support on the crosses. And investors will also be reluctant to chase USD/JPY up through 150 near term.

Chris Turner

➔ **PLN: First NBP meeting since the surprise rate cut**

Apart from this morning's retail sales data in Romania and Hungary, today's only event in the region is the meeting of the National Bank of Poland. The meeting is the first since September's surprise 75bp cut. We expect only 25bp this time, however, and survey estimates are between 0-75bp, which doesn't make things much easier. We also see unclear movements in both rates and FX in the markets, which can probably be explained by uncertainty about today's meeting. At the moment, the market is probably pricing in something between a 25-50bp rate cut for today.

We believe the NBP will choose a more cautious pace of rate cuts this time around, especially in an effort to keep the zloty in check. We are likely to see a decision today in the afternoon, although the time is not a given as always and tomorrow we have the governor's press conference at 15:00 local time where the main market attention will be directed. EUR/PLN has been moving up in a narrow range of 4.60-4.65 since September's jump and given the dovish market expectations, we see room for more of an upward repricing of rates which should support PLN. However, uncertainty for today and tomorrow is high and we see higher volatility beyond the current range.

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