

FX Daily: Upside gaps filled, now what?

High-profile equity markets, such as the S&P 500 and Nikkei's 255, have now filled the upside gaps after Monday's heavy losses. Failure to close above key levels such as 5300 and 36,000 on those two indices could warn of another bout of losses. Whether those losses occur will be a function of economic data and what, if anything, the Fed is prepared to do



➔ USD: How bad is the data and what is the Fed going to do about it?

We have seen a couple of better sessions for risk assets, where some stability in equity markets has allowed market interest rates to rise from panicked levels and allowed some of the battered risk currencies to claw back some of their heavy losses. Some high-profile equity markets have seen their recoveries stall at key technical levels such as 5300 for the S&P 500 and 36,000 for the Nikkei 255. Technical analysts would like to see these markets close above those key technical levels (upside gaps left by Monday's sell-off) before declaring that this corrective phase is over.

Determining whether those equity corrections continue or fizzle out will be the combination of US data and Fed speak. At the heart of the investment story is the issue of whether the US economy is going into recession – and if so, what the Federal Reserve is going to do about it. A recession

without a Fed response (were the Fed to be trapped by sticky inflation) could mean a flatter/inverted yield curve, heavy equity losses and a stronger dollar. Softer US data and a Fed response – perhaps signalled at the Jackson Hole symposium in two weeks – would deliver a steeper yield curve, more stability/recovery in risk assets and a broadly weaker dollar. We are more in the latter camp here and think that the dollar can soften more broadly over the next couple of months.

Also very much in focus is the size of the yen carry trade and whether a further unwind needs to drive USD/JPY sub 140 and spark more cross-market volatility. We expressed our views on this issue [last Friday](#). We suspect that the top layer of carry – speculators in yen futures markets – may be close to flat in their positions now. As to the deeper layer of the yen carry, we think it is very hard to tell. We would take any definitive declarations of the yen carry trade being 50% or 75% unwound with a pinch of salt. For the time being, however, it looks as though USD/JPY can hang around this 145/148 area. Over the next couple of months, we doubt it sustains a move over 150 and would expect the softer US rate environment to bring it back to the 138/140 area.

For today, let's look out for initial claims. A higher figure will add to fears of rising unemployment and a Fed response. This is a dollar negative. DXY may well be capped at 103.15/50 on any rallies, with a bias to press 102 over the coming weeks.

Chris Turner

➔ EUR: If markets can settle, EUR/USD should trade higher

As mentioned above, it is not quite clear yet that this corrective phase in equity markets is over. If it is, our view is that EUR/USD can reconnect with the sharp narrowing in eurozone:US interest rate differentials and can start trading over 1.10. That is our bias over the coming months. Helping that at some stage should be short-dated EUR rates, where the 81bp of European Central Bank currently priced for this year looks far too aggressive. Our house view is currently for just 50bp of further easing this year. We favour EUR/USD holding 1.0900 support and were US initial claims to surprise on the upside today, EUR/USD could take another run at 1.10.

Elsewhere, EUR/CHF had a decent bounce yesterday as market interest rates moved higher around the world. Some less dovish re-pricing of the ECB cycle could further help EUR/CHF, though we doubt it will be able to sustain gains over 0.9450/9500 in the currently stressed geopolitical world.

Chris Turner

➔ CEE: Zloty near the peak of repricing, waiting for the hawkish signal

Romania's central bank [cut rates again yesterday by 25bp](#) to 6.50% despite survey expectations, motivated by the recent reduction in inflation and its downwardly revised forecasts which opened up some policy space. In this context, additional rate cuts cannot be excluded in 2024, but given the absence of further downside surprises in inflation, this is not the base case of our economists.

July inflation numbers in Hungary were released this morning, posting increases of 0.7% month-on-month and 4.1% year-on-year, slightly above market expectations (0.5%/4.0%) and sending a mildly hawkish signal to the National Bank of Hungary. Elsewhere, in Turkey, the central bank will

present its inflation report. Otherwise, the calendar in the CEE region is empty today.

EUR/PLN touched new highs since mid-June yesterday following rates repricing and we think the gap we were highlighting here for some time closed between rates and FX at these levels. So, we could probably be close to a reversal in EUR/PLN. Market pricing is strongly on the dovish side in our view, with the first National Bank of Poland rate cut priced for December and the terminal rate at 3.70%. We see this setup as a major case for an upward repricing in rates after the rally in recent weeks within the CEE region. On the other hand, we won't see the first interesting data release in Poland until next week, and there is no NBP meeting in August, which usually gives a hawkish boost to the market. But the zloty is probably the currency with the most potential in the CEE region for a rebound at the moment – should investors get a signal to pay in the rates market.

Frantisek Taborsky

📈 MXN: Close call on a Banxico cut

There is a lot of focus today on whether Banxico will cut its high policy rate to 10.75% from 11.00% when it meets tonight. It has been on hold since it started its easing cycle in March, and economists are split down the middle on whether it will cut. Those in favour of a cut argue that real interest rates do not need to be this high anymore and that Banxico can resume an orderly softening of restrictive policy; those against a cut argue that the peso has been front and centre of the carry trade unwind and that a cut could prompt USD/MXN to trade over 20.00 again, destabilising local asset markets. We do not have a strong view here, but perhaps a hold under the next meeting on 26 September – a week after the Fed decision – might prove appealing to Banxico. If so, and assuming there is some stability in global risk assets and USD/JPY, USD/MXN could drop into the 18.85/19.00 area.

However, we are fearful of Mexican politics again weighing on the peso in September when the new parliament will discuss constitutional reforms. We struggle to see USD/MXN trading sustainably below 18.50 over the coming months.

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