

FX Daily: Yen funded carry continues to perform

Cross-market volatility levels remain low as expectations of early easing from the Fed ebb and flow. It is another quiet day for the data calendar and calm conditions are seeing yen-funded carry trade strategies continue to perform. In the G10 space, the dollar remains the go-to currency and in EM, the currencies of Mexico and Turkey are outperforming



➔ USD: What's on our radar?

It has been another quiet week in FX markets, where the dollar has largely held onto gains made after Friday's strong jobs report. These low volatility periods encourage more interest in carry trade strategies - which effectively see investors positioning in high-yield currencies to outperform their forward curves. For example, if you don't think USD/JPY will sink to its outright forward rate of 145.95 in three months, one might want to hold dollars. Similar strategies are being employed in the emerging market space, where investors are holding long MXN/JPY positions (spot now 8.69) on the assumption that it does not drop to its three-month outright level of 8.44. That is a 3% gain if spot goes nowhere. It also seems that investors are attracted to similar strategies in the Turkish lira. On the subject of yen-funded carry, the Bank of Japan policy meeting on 26 April is probably

the biggest threat to that trade.

What could rock these quiet conditions? Tonight sees a \$42bn 10-year US Treasury auction - we'll see how well that goes. Investors will also today be watching for any potential fallout on the US regional banking sector after Moody's cut New York Community Bancorp's (NYBC) rating to junk last night. So far the market is less concerned over systemic risk and seems happy to accept that pressure on NYBC has come more from the regulatory side after the bank's assets exceeded \$100bn. Probably the biggest event risk on our radar this week is Friday's release of the annual US CPI revisions. Do the strong disinflation trends of late 2023 get revised away and leave the Fed in a slightly less comfortable position (a dollar-positive event risk)? We'll discuss this topic in a little more detail later this week.

Perhaps the only slightly dollar negative scenario we see this week is one led by a risk-on environment should a Qatari-brokered Israeli-Hamas ceasefire make any progress.

Paying 5.3% on overnight deposits, the dollar therefore remains an attractive place to park money until some clearer trends develop. 104.00-104.75 looks to be the DXY range near term.

Chris Turner

➔ EUR: Bears not particularly enthusiastic

Even though EUR/USD has come lower, the FX options market suggests there has been little conviction about the move. For example, volatility has not picked up (higher levels would have been a sign that investors were positioning for a move lower in EUR/USD by buying FX options) and the 25 delta risk reversal - the cost of owning a EUR put option versus a similar EUR call option - has not budged either. If investors were positioning for a lower EUR/USD the EUR put option would become relatively more expensive. It therefore seems we are in a new EUR/USD holding pattern at slowly lower levels. That looks likely to be the case into Friday's release of the US CPI revisions.

In terms of the data calendar, we have just seen another soft German industrial production release. We doubt this is a market mover since Germany's industrial malaise is now a well-known story.

1.0725-1.0800 looks to be the short-term EUR/USD range.

Chris Turner

⬆️ PLN: Central bank to keep rates unchanged, again

The National Bank of Poland's reaction function has seen a shift since the country's elections from ultra-dovish to neutral. The central bank's rationale behind that move is the uncertain inflation outlook. NBP Governor Adam Glapinski suggested the Council would eye macro data and review its policy in March, after acknowledging the new NBP staff macro projection. The short-term inflation outlook has improved markedly versus the November projection. The mid-term prospects are a little more uncertain (i.e., the timing of rising VAT on food and lifting the freeze on energy and gas prices), but still, the inflation picture is not too different than before the elections.

Today, we expect rates to remain unchanged again and tomorrow's press conference will be more interesting. However, for the market it may be a confirmation that rates will indeed be stable for a longer period of time. The market is still pricing in more than 100bp of rate cuts for this year, while

we see room for cuts as very limited. Thus, further repricing to the upside may support the zloty, which weakened somehow this week. But yesterday, rates were already pointing to stronger levels and therefore today's decision may unlock some potential and return EUR/PLN closer to 4.320.

Frantisek Taborsky

➔ **MXN: Focus on Banxico's rate meeting tomorrow**

Some banks are looking for a slightly earlier-than-expected rate cut from Banxico at tomorrow's meeting. That is a little earlier than currently priced by the markets and presumably would see the Mexican peso sell off a little. However, Mexico currently has very high real rates - 6% using current inflation - and a modest reduction looks unlikely to do too much damage. At the same time, MXN price action shows it is far too early to miss out on 11% implied yields in the peso on the threat that Donald Trump may or may not be elected president in November.

We are still very positive on the peso.

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