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FX Daily: Yen missing out on equity sell-off

The souring in risk sentiment before tomorrow's Nvidia earnings is hitting high-beta currencies and offering some support to the dollar ahead of Thursday's September jobs reports. The yen is being held back by escalating tensions between China and Japan, as well as soft data and speculative flows testing the intervention threshold

Idiosyncratic factors continue to keep USD/JPY bid

USD: Global risk-off helping the dollar

The risk-off environment at the start of the week is prompting a return of safe-haven demand for the dollar. While valuation concerns ahead of tomorrow's Nvidia earnings release appear to be a key driver of the equity sell-off, the move has been global – not confined to US markets. That's what matters most for FX: as long as the sell-off is broad-based, the dollar can benefit from safe-haven flows.

Also supporting the dollar is a modest hawkish repricing at the very short end of the USD OIS curve. Pricing for a December Fed cut has been trimmed to 11bp from 15-16bp a week ago, bringing the implied probability just below 50%. This shift is, in our view, largely driven by recent Fedspeak, which has set a cautious, hawkish-leaning tone ahead of key data releases.

The BLS has announced that September's payrolls will be released on Thursday at 08:30 AM Washington time. That should limit the FX impact of tomorrow's FOMC minutes and could prove as pivotal for macro as Nvidia's earnings are for equities.

Our base case remains that risks are tilted to the downside for the dollar once the US data cycle kicks in, and we expect a December Fed cut to become the market's base case again. But for today, the dollar may stay broadly supported unless equities show signs of stabilising.

Francesco Pesole

EUR: Asymmetrical upside risks ahead

EUR/USD is holding near the 1.160 handle ahead of key US data, with the euro's liquidity helping it avoid a sharp hit from the equity sell-off. So far, losses in G10 FX have been mostly confined to high-beta currencies, notably AUD and NZD.

In our view, upside risks for EUR/USD persist. The pair has recently traded on the cheap side relative to its short-term fair value, but since French political risk faded, it has struggled to maintain an undervaluation greater than 1% for consecutive days. This morning's model estimate puts the undervaluation at 0.8%, suggesting the upside room is asymmetrically larger than the downside heading into key US releases.

Our year-end target remains 1.180. While the path higher may not resemble the one-way bullish traffic seen earlier this year, positive December seasonality could help smooth the move.

Francesco Pesole

JPY: Missing out on equity sell-off

The equity sell-off would generally set the perfect ground for a recovery in the oversold yen, but idiosyncratic factors continue to keep USD/JPY bid. The sudden escalation in Japan-China tensions has triggered retaliatory measures from Beijing, including travel restrictions, aimed at hurting Japan's profitable tourism business.

High-level diplomatic talks are already scheduled, and risks of further escalation do not seem too high. However, that is so far enough to cast more doubts about the ability of the Bank of Japan to hike rates in December. Adding to the dovish argument was data for the third quarter, released yesterday, which showed a 1.8% QoQ annualised contraction paired with a sub-consensus slowdown to 2.8% deflator.

Speculators remain clearly minded to buy USD/JPY and test the tolerance of the Ministry of Finance, whose verbal warnings tend to have a progressively smaller impact on the market. Our view remains that the MoF prefers to intervene in the FX market after a USD-negative event (such as a soft jobs/inflation print), like it did in July 2024. Also, any line in the sand may be closer to 160, and we could see further upside pressure in the coming days.

Francesco Pesole

HUF: NBH answering fiscal increase

The National Bank of Hungary will decide on rates today, but the decision itself should be a non-event. However, forward guidance will be more important than ever. Over the last two weeks, we have seen several headlines from the government about increasing the public deficit this year and next year to 5% of GDP. At the same time, there have been many spending and tax measures to support household consumption and the decision to extend the government's price measures.

Inflation is roughly in line with expectations and the path is favourable for the next few months. The fiscal picture has changed significantly. Therefore, it will be important to see whether this changes the tone of the NBH in any way. In the baseline, nothing other than a hawkish tone can be expected, just like the last few meetings. At the same time, we should see some effort to strengthen the hawkish tone regarding the rate of increase in the fiscal deficit (from 3.7% to 5.0% next year).

On the other hand, there is not much more the central bank can do here, and market pricing has already shifted in a hawkish direction. The market is pricing in 58bp of rate cuts over the two-year horizon, and the terminal rate is the highest since April. Therefore, overall, we see more risk on the dovish side given the hawkish market stance. Therefore, we see a case for more steepening of the curve in the current environment.

FX should remain under control in our view. The new US “financial shield” seems to have been taken seriously by the market, which is likely to keep any sell-off shallow, and the market will quickly fade any weakness in HUF. Therefore, we do not expect to go above 386 EUR/HUF anytime soon. At the same time, there is no more impetus to go further down for now, unless the NBH surprises with a more hawkish tone.

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