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SMBC Capital Markets, Inc.

fxPoetry

September 22, 2022

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A Crash Dive

Stealth intervention
Though sometimes intervention
Can be clear as day

"*We won't raise rates for some time. We have thoroughly debated what's the best monetary policy while considering what will happen from here and concluded that we will continue with monetary easing.*" This comment from BOJ Governor Haruhiko Kuroda last night exemplifies why the yen has further to fall. Forty-five minutes later, the yen rallied as much as 3.5% from its newly achieved 24-year lows of 145.90 as the BOJ, on behalf of the MOF, aggressively sold dollars in the market. This was confirmed by Masato Kanda, the MOF's top currency official, who earlier in the day had suggested intervention may happen on a "stealth" basis. The ongoing problem for the yen is that as long as the BOJ maintains its current policy set, -0.1% base rate and YCC with a 0.25% cap on 10-year yields, the yen has only one way to go, lower. Intervention will be a very short-term solution, one which has already, only a bit more than an hour after it occurred, been almost completely undone. While I expect that we may see more efforts by the MOF to slow the yen's decline, at this point, it seems quite clear that USDJPY is going to head to ~~infinity~~ 150.00 and beyond.

In Zurich, the National Bank
Is worried about the Swiss franc
But seventy-five
Led to a crash dive
For this they have Powell to thank

As this is central bank week, and as we await the BOE shortly, a brief word on the Swiss National Bank, which raised their base rate by 0.75% to +0.50%. This leaves the BOJ as the last bastion of negative interest rates in the world. However, the market response was clearly not what the SNB was seeking as the Swiss franc has fallen -1.1% after the news. It seems market participants were expecting 100bps on the back of recent comments that the SNB actually would like to see a strong franc. This is quite a shift from the past 10 years, where the SNB did all they could, including pushing deposit rates to -1.25%, the lowest in the history of the world, in an effort to dissuade buying. But suddenly, as inflation continues to rise there, touching 3.5% in August, the highest level since 1993, the SNB has decided a stronger franc suits their needs better. Alas, for the SNB, a single 75bp rate hike is peanuts compared to what Chairman Jay has been doing, 300bps in the past six months with another 150bps to come in the next six, and so USDCHF continues to rise. As with Japan, unless policies really change, the FX market will continue on its current trajectory.

Now let's talk 'bout Jay and his team
Who made it quite clear that their dream
Is much higher rates
'ven if that creates
No growth for the current regime

And now a quick word on yesterday's FOMC meeting, where the policy adjustments were exactly as expected, a 75bp rate hike and no change to the pace of QT, while the 'not-forward' guidance of the SEP and the dot plot showed the Fed expects short term rates to peak at 4.6% next year and slowly fade back, while they also expect GDP growth in 2022 of just 0.2% rising back to 1.7% in 2023 alongside an Unemployment Rate of 4.4%. In truth, this would be a historical anomaly as never before has the Unemployment Rate risen more than 0.5% without the US economy falling into recession, and yet the Fed's expectations are for growth, albeit much slower growth. At any rate, during the press conference Powell was extremely clear that the Jackson Hole message remains the roadmap, if anyone didn't get the message from the dot plot or the SEP.

It seems abundantly clear that the narrative is shifting once again. While the summer narrative was filled with hope that the Fed would pivot to lower rates responding to the coming recession, and risk assets benefitted, Powell and his central bank brethren (Kuroda excepted) have made it clear that inflation is job #1 and they will continue to raise rates until it is dead. There is little concern about growth or employment, only price stability will suffice. I can see no path where the dollar reverses course until such time as the Fed declares victory and it is clear they see their goal in sight. According to their latest estimates, that will be some time in 2024 at the earliest, and that means the dollar could go much further. Remember, the historic highs for the dollar are substantially higher than the current levels; EUR 0.8230 in 2000 and heading back to 1985, the effective euro fell to 0.6444; GBP 1.0520 in 1985; JPY 262.80 in 1985, although in history it had been much higher, well over 300. The point is, just because we have not seen these levels in a generation or two does not mean we cannot get back to them.

Adding to the dollar's appeal is the ongoing Ukraine conflict where yet again, early this morning, the Russians explained that all means of defending Russian territory are on the table, including nuclear weapons. This was referring to the referenda that they are holding in the four eastern Ukrainian provinces which they expect to declare as part of Russia next week. The point is, the dollar remains, in the eyes of most of the market, the safest of havens with respect to where investors can expect to have access to their savings and capital. I'm afraid the world is at a difficult juncture right now, and sincerely hope we get through it alright.

Quickly to markets, where risk is not in favor today. After yesterday's selloff in the US, Asia (Nikkei -0.6%, Hang Seng -1.6%, Shanghai -0.2%) fell and we are seeing weakness across the board in Europe (DAX -0.6%, CAC -0.75%, FTSE 100 -0.25%). US futures, just before 7:00am, are up the slightest amount, 0.1%, but I wouldn't get too excited about that.

Bond markets are mostly rallying this morning after yesterday's fireworks as fear seems to be overwhelming the concerns raised by the Fed and its brethren. Treasury yields are ever so slightly lower, -0.2bp, while we have seen more substantial bond rallies in Europe (Bunds -3.7bps, OATs -4.2bps, Gilts -1.7bps, BTPs -8.3bps) with that Bund – BTP spread actually narrowing a bit. Meanwhile, the US yield curve has inverted even further with 2yr yields now at 4.09% and the inversion up to 57bps.

Oil prices (+0.6%) are a bit firmer this morning although remain at the bottom of their trading range, while NatGas (-0.4%) has edged a bit lower. Gold (-0.4%) which saw a decent rally yesterday despite the Fed's moves is giving some of it back while copper (+0.4%) is edging higher.

While overall, the dollar remains extremely well bid, given the runup yesterday, as well as the intervention we have seen, it is no surprise that it is somewhat softer this morning. In the G10, only the CHF (now -1.5%) is weaker while JPY (+1.0%) leads the gainers. The BOE raised rates by 0.50%, as widely expected just a minute ago, but the pound, which had been firmer, is sliding a bit and now up just 0.25%. SEK (0+0.6%) is the next best performer after the yen, which is really a reaction to the fact that despite a 100bp rate hike yesterday, the krona fell sharply.

Emerging market currencies are split as APAC currencies showed weakness (KRW -1.2%, INR -1.1%, PHP -0.85%) after the Fed's action and ensuing risk-off attitude, but the EEMEA bloc seems a bit more comfortable this morning (HUF +0.9%, ZAR +0.9%) as does MXN (+0.8%), which also seem to be retracing some of yesterday's underperformance. Notably, despite CPI inflation of 80% in Turkey, the central bank there cut interest rates by 100bps this morning. Surprisingly, the lira (-0.3%) has not fallen that much.

On the data front today we see Initial (exp 217K) and Continuing (1418K) Claims as well as the Leading Indicators (-0.1%) a little later. There are no Fed speakers today, although Chairman Powell will speak tomorrow afternoon.

The big picture remains the dollar has further to rise. As the Fed continues to be, by far, the most aggressive of the G10 central banks with respect to policy tightening, it is very clear. While we will have days where other currencies shine, I see nothing to change this view until policies change. Perhaps, at some point Secretary Yellen will become uncomfortable with the dollar's strength, but more likely, the Fed will keep raising rates, crack the economy and inflation will fall alongside demand opening the way for easier money. However, I believe that day remains well into the future. Hedgers, take advantage of dollar pullbacks as they are likely to be short-term in nature.

Good luck and stay safe
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The views expressed are his own and may differ from Research.