SMBC Capital Markets, Inc.

fxPoetry

September 14, 2022

Andrew Fately
Executive Director, Senior FX Marketer
Global Markets Marketing Department
andrew_fately@smbcgroup.com
Direct: +1 212-224-4532
Representative: SMBC Capital Markets, Inc.

Alas, CPI

Kuroda checked rates
Is intervention coming?
Does day follow night?

“*We are concerned by excessive volatility in the currency market. We are ready to take necessary steps if current forex moves continue, without ruling out any option*.” Japan’s Chief Cabinet Secretary, Hirokazu Matsuno, regaled us with these comments last night.

FinMin Shunichi Suzuki had this to say as well, “*Recent Forex movements have been somewhat erratic. Rapid FX moves are undesirable. I believe Forex rates should reflect fundamentals*.”

You better believe the Japanese government is getting concerned about the yen’s weakness. In fact, last night the BOJ conducted a “rate check”, a procedure when they call around to the Japanese banks to determine the current market situation, and a procedure seen as a potential precursor to actual intervention. In fact, Suzuki explicitly said that intervention was possible when asked during a press conference.

Here’s the thing…it won’t really matter. Yes, if the BOJ intervenes then USDJPY is going to fall initially, and probably a decent amount, something like 3% or so. But the yen is weak because of the policy choices made by the BOJ to maintain YCC and NIRP at the same time that virtually every other nation in the world, especially the US, is in the process of tightening monetary policy aggressively. After all, the yen was the second-best performer in the G10 yesterday, falling a mere 1.2% on the day, much less than NOK (-2.6%), AUD (-2.3%) or SEK (-2.0%). Granted, the yen’s weakness has been pervasive all year, especially since March, but unless there is a policy shift, any intervention is going to have a short-lived impact on the market. And the second round will have even less impact. Ultimately, this still remains a dollar story.

Ere yesterday what many hoped
Was prices were now downward sloped
Alas, CPI
Continues to fly

And bulls sold their stocks and all moped

By now you are well aware that the CPI report was a tad higher than forecast, especially the core reading, which rose back toward the March 2022 highs of 6.5%. This is a bigger problem for the Fed because it is much harder for them to blame price movements on things like gasoline, which fell sharply during August, or airfares, which also fell, when Core Services prices rose at their fastest pace, 6.1%, since 1990. This includes things like rent, medical services and recreation among others. And history shows that it tends to trend for a while when it gets going. In other words, the Fed seems likely to have to raise rates a bit more than the market had anticipated just two days ago.

Given the constant hype that the bottom was in for stocks, and that recent prices were a great opportunity, as well as that a soft landing was a growing probability, it should have been no surprise to see markets respond like they did yesterday, with equities routed, bonds sold off sharply and the dollar exploding higher. After all, the news has not merely cemented a 75bp rate hike next week by the Fed but opened the door for 100bps. And as of now, the Fed whisperer, the WSJ's Nick Timiraos, has not pushed back on that new narrative, saying only that *"..clinches the case for the Federal Reserve to lift interest rates by* ***at least*** *0.75 percentage point at its meeting next week…"* [emphasis added] Recall, too, the level of hawkishness we had heard from Mester, Waller and Powell himself just before the quiet period began last Friday.
One week ago, Fed funds futures were pricing the terminal rate at 3.898% in March with a 76% chance of a 75 basis-point move next week. This morning that terminal rate is 4.358% with a 33% chance of a 100 basis-point move next week. The narrative that the Fed is going to pivot soon is, if not dead, at least in hibernation until the next CPI report in October. Another strong print there may well kill it completely.

One last thing to remember about the idea of a bear market. Bear markets in equities don't end when investors are trying to figure out what dip to buy, they end when investors don't want to even discuss equities and would rather talk about anything else. As difficult as that will be these days given the vast amount of overreporting on the stock market, while declining market prices are still front-page news, there is further to go. Only when the discussion turns elsewhere, and equities are a complete afterthought will it be reasonable to believe the bottom is in. We ain't there yet!

Looking at the follow-on to yesterday's absolute equity market rout in the US, we see mostly red on the screen everywhere. The Nikkei (-2.8%) was the weakest in Asia followed by the Hang Seng (-2.5%) and Shanghai (-0.8%). Europe, which had the 'benefit' of being open yesterday when the CPI news hit and fell on the order of -2.0% in major markets, is continuing its decline, albeit not as steeply. The DAX (-0.5%), CAC (-0.3%) and FTSE 100 (-0.9%) are all softer, with the latter suffering from continued inflation problems as well as Core CPI there rose to 6.3% (although headline fell to 9.9%). Inflation is not a uniquely American issue by any stretch, and in fact, Europe is likely in much worse shape. Finally, US futures markets are higher by about 0.4% at this hour (7:00am) but that is well off earlier session highs and seems destined to fail as the day goes on.

Bonds, too, were routed yesterday with yields exploding higher as investors and traders all realize that interest rates are moving higher, and the central banks are going to need to raise rates a lot more to rein in inflation. So, this morning 10-year Treasuries (+3.3bps) are softer although the real movement was in the 2yr yesterday, which saw yields jump 18bps and are higher by a further

2.2bps this morning. The picture in Europe was similar, with higher yields yesterday and further movement in that direction today (Bunds +2.2bps, OATs +2.5bps, Gilts +1.1bps, BTPs +4.5bps) which is putting even more pressure on the Bund – BTP spread. Even JGB's (+0.8bps) are back to their 0.25% cap and have required further buying by the BOJ.

Despite, or perhaps because of, all the inflation angst, oil (+0.6%) is higher this morning and to my untrained eye looks very much like the lows seen last week, at $81.33/bbl, may well be the lows for the move. Rather, I expect that still high NatGas prices in Europe will force a lot more gas-to-oil switching for electricity production and increase demand at the margin, recession or not. Speaking of NatGas (+1.4% in US, +7.25% in Europe) it too seems to be continuing to trend higher with a lot of reasons to believe this trend will continue. In the metals markets, it should be no surprise that gold (+0.1%) got crushed yesterday with the combination of higher yields and a stronger dollar. But this morning both copper (-0.9%) and aluminum (-2.3%) are both under increased pressure.

Finally, the dollar has seen a bit of a retracement from yesterday's extraordinary strength with JPY (+0.95%) the leading gainer in the G10 on the back of the step-up in BOJ attention discussed above. Then GBP (+0.6%) is next as traders anticipate a more hawkish BOE, followed by the rest of the European currencies with much lesser gains. As it happens, the Commonwealth currencies are actually a touch softer (-0.1%) again today. In the emerging markets, MXN (+0.4%) and CZK (+0.35%) are today's leading gainers, and this is after substantial weakness across the board yesterday in this bloc as well. Meanwhile, KRW (-1.25%), THB (-1.0%) and TWD (-0.7%) all fell sharply in their sessions overnight simply responding to US market conditions. But in the end, as long as the Fed remains the most hawkish of the central banks, the dollar seems likely to continue to rally.

On the data front, PPI (exp 8.8%, 7.0% -ex food & energy) is this morning's only release. Those outcomes would be substantially lower than the July data but remain well above CPI and a source of pressure on corporate margins. Obviously, there are no Fed speakers during the quiet period, so my take is regardless of the PPI print, the pressure for the dollar to continue to rally is going to be strong. It seems unlikely, though not impossible, that the BOJ would enter the market in US hours, so I look for this move to continue.

Good luck and stay safe
Adf