

The FX Trader The USD and risk sentiment a bit different now

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Summary: A wild day on Wednesday as a hot US CPI number at first pumped the US dollar and US treasury yields higher, only for both to reverse sharply lower. At the same time, US stocks sold off throughout, suggesting that the US dollar correlations with risk sentiment may not be what they used to. Elsewhere, weak Australian jobs data combined with weaker global risk sentiment pushed the AUD broadly lower overnight.

Wild reaction to US CPI data – a USD top in place? The US dollar and US treasury yields saw a wild reaction to the hot US CPI numbers, which were 0.1% higher than expected for the core month-on-month and year-on-year readings at +0.3% and 2.6%, respectively. The headline rose 0.1% more than expected to 3.7% YoY vs. 3.4% in August. The USD and treasury yields bolted higher on the data, with the benchmark 2-year US treasury yield up over 15 basis points at one point before the move was entirely erased, especially at the long end where the move was not only reversed, but saw the 10-year benchmark treasury yield, for example, crushed to a lower close on the day and lower still overnight, hitting below 5.10% for the first time in over a month. The US dollar likewise reversed, if with a bit less amplitude in relative terms, especially in USDJPY (more on that below). The reversal is particularly powerful as it unfolded at a new cycle high for the US dollar, though its magnitude is still rather modest relative to the massive rise in the currency over the last several weeks.

Takeaway: Yesterday's action so far looks like a key reversal for the US dollar, given that we have the most important data point (the CPI) delivering a supportive print, but then the greenback and US yields reversing heavily after the initial reaction. Looking forward, further weak risk sentiment globally may not be supportive for the big dollar – because weaker risk sentiment would inevitably center on the massive portfolio flows linked to US AI stocks – a further mark-down there means a potential exodus and potential exodus from USD-denominated stocks, but it also could mean a far weaker US economy and therefore a massive reversal in Fed policy projections eventually.

Chart focus: EURUSD EURUSD slipped all the way to 1.1113 after the hot US CPI release yesterday before rallying back as high as 1.1240. It's a classic one-day reversal, made all the more emphatic by occurring over a key macro event risk that should theoretically have supported the US dollar. Interestingly, it also came within four pips of testing that 50% correction support point and the 200-week moving average. From here, the focus higher could center on the prior range low of 1.1325 and then into the 38.2% Fib retracement near 1.1340, but the bar is quite high for a full reversal, which would require something like the 1.1500 area to come into play and it is far too soon to bring that kind of level into the picture.

JPY – what does it take to get more support for the yen? The JPY behaved directionally as one would expect over and after the US CPI data if we use US treasury yields as our coincident indicator, but we wonder why the JPY couldn't post an even better performance, given the huge swing in US long yields in particular. Lower risk sentiment and safe haven seeking in bonds was supposed to be the mix most supportive of a stronger JPY comeback, but the move has so far underwhelmed. We need to give the

market more time to adjust to a head-spinning move like yesterday's, but either JPY is mispriced on the weak side here or we need to go back to the drawing board on market drivers.

AUD – weak risk sentiment and weak jobs report.

The Australian dollar was in for a drubbing overnight on the combination of weak global risk sentiment, which also saw pro-cyclical metals prices under pressure, and weak Australia September employment data, with the Unemployment Rate revised up for August to a new post-pandemic high of 4.7% and staying at that level for September (despite a 0.2% drop in the participation rate), while the employment change number for the month was -39k. But there is more going on in the background in Australia as well, as consumer confidence and household finances are feeling the pinch from higher interest rates more quickly than in many other countries as most Australians finance their mortgages on floating rates. Home prices are falling and volumes are falling. Arguably, the recent AUD strength already looked over-stretched relative to interest rate differentials in a cross like AUDNZD and the reversal overnight could mean we have a top in place for the AUD for some time here in many crosses.

We have US Retail Sales and US PPI for September up today, but hard to imagine that these are directly responsible for fresh drama. It was yesterday's CPI that set things in motion and now it is about whether global risk sentiment can find its feet here or we are in for a bigger mark-down in risk assets, one that, as we argue above, could prove surprisingly non-supportive for the US dollar. The JPY, EUR and CHF might benefit the most, provided European sovereign yield spreads stay quiet. On that last point, lower yields might throw France a helping hand for now.

FX Board of G10 and CNH trend evolution and strength. Note: If unfamiliar with the FX board, please see a video tutorial for understanding and using the FX Board.

A big jolt lower for the AUD (note the hefty negative shift in the 2-day momentum), while we can also see there is a lot more needed to reverse the USD bull run. As well, the positive JPY shift after yesterday's and today's global bond market rally is underwhelming at best – but let's give it another couple of days. Also, after the EURUSD reversal and the EUR putting up a fight in other crosses yesterday, wondering if other G10 currencies might pick up the race to the bottom.

Table: NEW FX Board Trend Scoreboard for individual pairs.

EURSEK has flipped into a negative trend according to our trend definition, but the prior rally there has been so large that a bigger move lower is needed to register a more profound reversal. In other individual pairs, will be watching for whether the EURAUD negative trend is set for a reversal and whether this latest USDJPY "uptrend" status reverses, though that pair has been impossible for both bulls and bears in recent months.

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