Daiwa Securities

Daiwa's View

MOVE index pointing to end of USD appreciation?

- Reduced interest rate volatility due to recovery of Fed's forward-looking nature may signal end of strong USD trend

Fixed Income Research Section
FICC Research Dept.

Senior FX Strategist
Kenta Tadaide
(81) 3 5555-8466
kenta.tadaide@daiwa.co.jp

Daiwa Securities Co. Ltd.

MOVE index pointing to end of USD appreciation

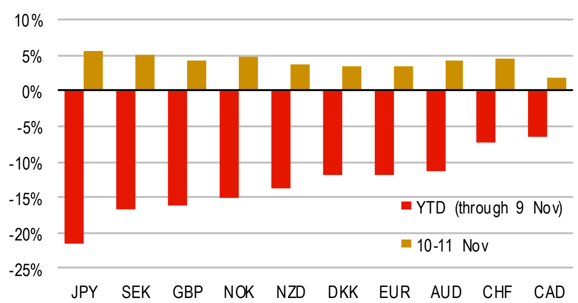
Reduced interest rate volatility due to recovery of Fed's forward-looking nature may signal end of strong USD trend

October US CPI, released on 10 November, rose at a smaller-than-expected rate, triggering strong selling of the dollar on currency markets (see 11 Nov *Daiwa's View*: An end to "inflation trade"). Those currencies that were heavily sold off since the beginning of the year have rebounded strongly (Chart 1) with Japan's currency appreciating seven yen in just two days.

There has been a sudden awareness that dollar appreciation could be nearing its end, ever since comments made by Federal Reserve presidents James Bullard (St. Louis) and Mary Daly (San Francisco) on 21 October, as well as a Wall Street Journal report, suggesting a slower pace of rate hikes at the December FOMC meeting (also ever since MOF's USD/JPY currency intervention). US October CPI data provided strong support for a "slowing of the pace of rate hikes" that was clearly on the table for discussion in the November FOMC statement, and a 50bp rate hike at the December FOMC meeting seems to be a done deal. As a result, the peaking of dollar appreciation, which had been driven by the Fed's hawkish stance, is becoming clearer.

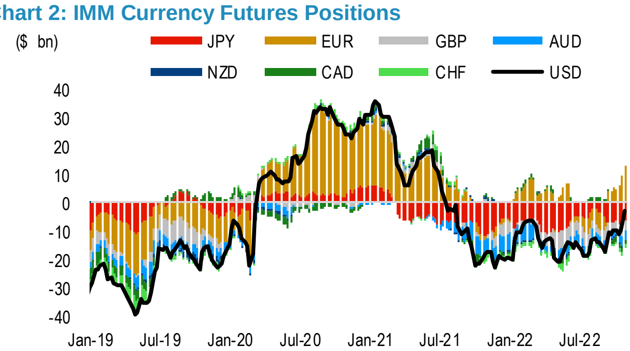
According to IMM currency futures positions published by the US Commodity Futures Trading Commission (CFTC), long positions held by speculators (non-commercial) involving the US dollar and a basket of eight major currencies have been meaningfully scaled back over the past three weeks. More recently, there was noticeable repurchasing of the yen and British pound, which had relatively large remaining short positions. We think dollar buying positions built up on account of expectations for higher US interest rates were unwound all at once (Chart 2).

Chart 1: Up-down Ratio of Major Currencies (vs. USD)



Source: Bloomberg; compiled by Daiwa Securities.

Chart 2: IMM Currency Futures Positions

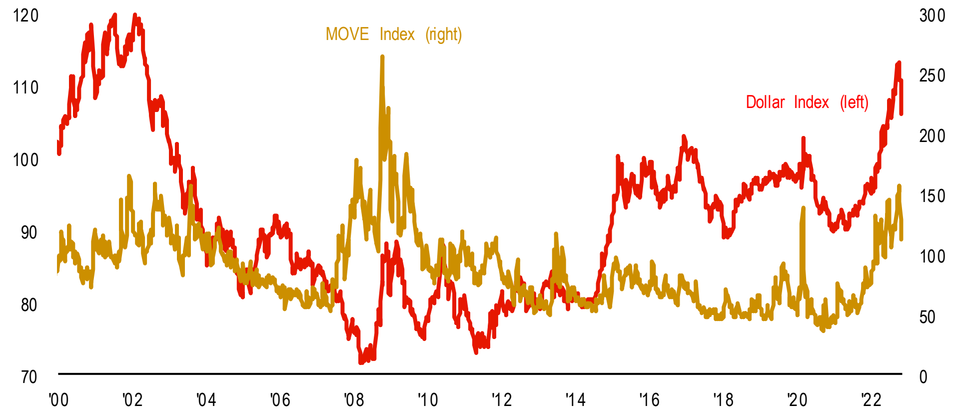


Source: CFTC, Bloomberg; compiled by Daiwa Securities.
Note: Positive values indicate buying each currency/selling the USD, and negative values indicate selling each currency/buying the USD. USD is sum of net positions in each currency.

The dollar's strength since the beginning of 2022 has been led by higher-than-expected CPI. The higher CPI readings were surprising considering the expectations for further FRB rate hikes with market participants intermittently adjusting higher their view of the terminal rate (level at which Fed is expected to stop raising interest rates). Naturally, this meant a widening of the relative interest rate differentials between the US and other countries, which accelerated dollar appreciation. At the same time, difficulty determining the terminal rate increased bond market volatility, as seen in the rise of the Merrill Lynch Option Volatility Estimate (MOVE) index. In other words, the rise in the MOVE index can be seen as a litmus test for the market's willingness to hedge the risk of a terminal rate spike. As shown in Chart 3, there has been very strong correlation between the USD index and the MOVE index since 2021.

After the coronavirus shock, the FRB fell "behind the curve" (was not raising interest rates fast enough to keep up with inflation). In order to rectify that situation, the FRB set inflation control as its top priority by making an unconditional commitment to curbing inflation. As a result, monetary policy took on a certain backward-looking nature. While influenced by recent CPI data, the FRB successfully returned to a forward-looking nature at its November FOMC meeting. This means that CPI upturns for individual months are no longer likely to produce disorderly terminal rate increases. The rate hikes to date have generally brought the terminal rate closer to an appropriate level, and we have now entered a phase where smaller adjustments will be made. The remaining issue is how long that level should be maintained. The situation has changed to a declining MOVE index and a reversal from dollar appreciation to depreciation.

Chart 3: Dollar Index, MOVE Index



Source: ICE, Bloomberg; compiled by Daiwa Securities.

Daiwa Securities

IMPORTANT

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:
https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association