Getting Carried Away

Since FOMC Chair Powell's congressional testimony last week, FX carry has been on a tear. No doubt the prospect of Fed easing has touched off something of a rally in risky currencies.

Today's chart shows the performance of 32 liquid currencies, decomposed into spot returns versus interest returns. The upward slope of the fitted trend line indicates that higher-yielding currencies have generally outperformed lower-yielding ones.

The grey dots in the scatter show that the relationship between interest and spot returns between the end of May and the end of June was inverse; lower-yielding currencies posted the better spot performance.

The risk-seeking behavior that we currently observe in FX markets is in line with what one would expect at the beginning of a bout of policy easing from the world's most important central bank. Now that the Fed has pretty much assured us a cut is coming at the end of the month, the market is hoovering up carry, leading to rallies in high yielders.

The Federal Funds market is placing heavy bets on a 50 basis point cut at the July 31 FOMC. If the Fed disappoints (and we think that 25 basis points of easing is more likely than 50), this carry trade could find itself rapidly reversed.

Carry Back in Vogue Post-Powell Testimony
SOURCE: Bloomberg, data for 18 July 2019. NOTE: All returns are expressed in log differences and holding periods have been scaled to be equal for both periods under consideration.

Please direct questions or comments to:

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