FX Daily: Sizing the correction

Minutes from the Federal Reserve's last meeting have disappointed risk assets. But the corresponding dollar rally should prove limited

Fed Chair, Jerome Powell

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USD: Corrective dollar rally should prove limited

Risk assets around the world are suffering a corrective 24-hours. The catalyst has been a set of FOMC minutes that has failed to feed the rally, offering neither enough clarity on strategy changes nor fresh stimulus. James Knightley's take on the minutes can be found here. In reality, the move in risk assets and the dollar (two-thirds of the dollar rally was seen before the minutes were released) looks to be position adjustment. After all, it looks quite clear that there will be a Monetary Policy strategy announcement at the 16 September meeting and with Treasury yields already low and USD money market curves very flat there was no pressing need for immediate Yield Curve Control (YCC). But the fact that a 'majority of participants commented on yield caps and targets' suggests YCC is a very live debate. Equally, with the Jackson Hole virtual conference taking place 27/28 August, we expect this topic to be back on the market's agenda soon. In short, we do not see recent trends reversing and the challenge is to size the correction. Our best guess is that the dollar could enjoy another 1-1.5% corrective rally, e.g. best case 94.00/94.30 for DXY, before turning around and hitting a new low. Look out for US initial claims today.

EUR: Outside risk to 1.1670/1700

As above, were position adjustment to run a little further, EUR/USD could trade down to 1.17. But we're very happy with a one-month target of 1.20. Of note to us yesterday was the big rally in USD/CHF from just above 0.90, which seemed to lead the dollar move. Could it have been Swiss National Bank FX intervention? Elsewhere today look out for Norges Bank. A mildly upbeat 3Q expectations survey favours a little Norges Bank optimism and could send EUR/NOK back to 10.50.

GBP: Complete reversal of Tuesday's rally

A technical correction looks to be on the cards – Cable risking 1.29.

TRY: CBT may examine tighter policy today

The Central Bank of Turkey meets today to set monetary policy. No change is expected in the one-week repo rate at 8.25%. Through channelling liquidity via a variety of its instruments the CBT has, however, been increasing the effective cost of funding to local banks from 7.5% in July to around 9.5% currently. The question is whether the CBT wants to emphasise the threat of even higher effective funding costs – by perhaps raising the policy corridor from its current 6.75-9.75% range – or would prefer to leave all rates (including the 11.25% late liquidity window) unchanged and instead deliver a hawkish message. On balance we think the CBT would prefer to use its current arrangements to deliver any further increase in effective funding costs. Potentially positive news of the discovery of Black Sea energy might also encourage the CBT to stand pat.

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