FX Daily: Talking Turkey

Asset markets seem to be settling into some conventional mid-cycle trading patterns, where bond yields are rising as central banks withdraw stimulus, while equity markets continue to perform well. A quiet week for the Fed story has seen commodity FX rebound. These trends can continue for a while. Look out for an important rate meeting in Turkey today.

USD: 10yr Treasury yields at 1.65%, equities at record highs

Earlier in the year, when the strength of the recovery was uncertain, a popular question to ask investors was at what level would rising US 10yr Treasury yields trigger a correction in US equities? The answers at the time were somewhere in the region of 1.75-2.00%. Today, though, 10 year US yields are rising in an orderly manner and global equity markets continue to perform well. The moves seem consistent with mid-economic cycle trading patterns. Concerns have switched from deflation to inflation, central banks have started/are preparing to normalise monetary policy, bond yields are rising and equities continue to rally. Typically equities are the last asset class to turn in the cycle and typically six months before a recession.

Overlaying this cycle to FX we would say that the dollar can continue to perform against the low-yielders, but with equities staying bid, selective commodity/high yield currencies can continue to out-perform. That is the pattern we have seen over the last week. Outperformers in G10: NZD, NOK, AUD. Under-performer: JPY. In EM: Out-performers ZAR, MXN, CLP. Under-performers BRL & TRY (local stories playing a role here).

As our commodities team point out today, energy inventories remain low and high energy prices look here to stay over coming months. This should continue to favour the haves over the have nots in the energy space and currencies of those central banks that look ready to respond to higher energy prices - this theme has driven NZD this week.

Given that DXY is heavily-weighted to European FX - and Europe does not look well-positioned on energy or supply chain disruptions - we prefer the DXY correction lower finding support around the 93.50 area, with outside risk to 93.10/20. But we still favour a bullish DXY trend into late November, helped also by the needs for many banks to secure dollar funding for year-end capital adequacy inspections.

For today, US data are the initial claims and existing home sales data. At 15CET we'll also hear from Fed's Waller. He's been sounding slightly hawkish, warning that if inflation stays high over coming months, the Fed might need to bring forward rate hikes. (So much for the new Average Inflation Targeting framework!)

EUR: Should be an ideal funding currency

Barring a surprise shift in ECB dovishness, the EUR should be an ideal funding currency this autumn. EUR implied yields remain deeply negative and some of the commodity currencies are backed by very attractive yields these days - particularly the Rouble.

For EUR/USD, so far this week's correction has stalled in the 1.1660/80 area and again we would have to a rethink on our near-term bearish view were EUR/USD to start closing above 1.1700 or DXY close below 93.10/20.

GBP: Holding gains

GBP has held onto recent gains despite the narrative of a looming policy error. Again we are not a big subscriber to that view yet. The greater risk right now is that a pro-risk mood sees the dollar weaken across the board as money gets put back to work and something like GBP/$ breaks resistance at 1.3830 in a move up to the 1.3915/30 area.

TRY: Could Turkey leave rates unchanged?

Given a key FX market narrative has been high energy prices and what central banks are prepared to do about them, Turkey's large energy importer status and a central bank looking to cut interest rates have left TRY vulnerable.

Consensus expects a 100bp rate cut at today's Central Bank of Turkey (CBT) rate meeting - which again could hit the TRY. Our team thinks that the CBT may choose to pause given that five out of the six core inflation measures are rising. That could provide some temporary support for the TRY, yet multi-month energy and inflation trends are against it.

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