

FX Daily: Three FX takeaways from the FOMC minutes

Last night's release of the 27 July FOMC minutes was perhaps not the financial market bombshell that some were thinking. Yet we read three important takeaways for the FX market. These should contribute to the dollar staying bid against the low-yielding euro and yen, while not discouraging some selective interest in the FX carry trade



We may see a wait-and-see approach by markets today ahead of tomorrow's FOMC meeting

➔ USD: Steady Fed to keep the dollar bid versus low yielders

Reading through the FOMC minutes last night, we took away three key points for the FX market.

1. The Fed felt that the appreciation of the dollar was helpful in suppressing import prices and contributing to the Fed's objective of bringing inflation back to its 2% target. In other words, the Fed seems to welcome dollar strength and there were no linkages of dollar strength depressing any sectors in the US economy.
2. The Fed noted that the dollar had continued to strengthen in the inter-meeting period, especially against the euro. The Fed blamed the move on wider interest rate differentials. We see these interest rate differentials (two-year swap differentials) [widening further into year-end and keeping EUR/USD pinned down near these 1.00/1.02 levels.](#)
3. The Fed acknowledged the risk of tightening more than necessary - a risk that in effect

justified slowing the pace of rate hikes and shifting to a more data-dependent approach. Within FX markets, selective high-beta, risk-sensitive currencies may perform a little better on the view that the Fed is shifting away from the period of more forceful adjustments in the policy rates.

[As James Knightley notes](#), there are still three big event risks ahead of the 21 September FOMC meeting which will help determine whether the Fed hikes 50bp or 75bp. These are the Fed's Jackson Hole symposium (25-27 August), the August jobs report (2 September) and the August CPI data (13 September).

How should FX markets trade beforehand? The surge in gas prices has been dominant in FX markets this week and the theme of energy dependence suggests the dollar remains bid against the euro and yen. The wild card of another renminbi devaluation also hangs as a spectre over most currencies (except the dollar), but many assume the People's Bank of China will not allow the renminbi to substantially depreciate ahead of the all-important National Congress sometime in November. Let's see.

The more data-dependent approach from the Fed is a slight positive for the risk environment and favours selective carry. [Last week](#) we highlighted that a cross rate like MXN/JPY might perform well (MXN 3-month implied yields are near 10%) and we still like this strategy.

The US data calendar is quiet today and DXY can trade near the top of a 106.50-107.00 range.

Chris Turner

📌 EUR: Staying offered, look out for EUR/NOK today

EUR/USD failed to find any positives from last night's FOMC even though US yields softened a little. The unrelenting negatives emerging from the gas crisis no doubt continue to weigh on the euro and suggest EUR/USD may struggle to hold gains over 1.02 today. Fund managers continue to believe the euro is undervalued - but they have been saying that since 2018. And we think the gas crisis and terms of trade shock has driven [a lower fundamental value for EUR/USD](#).

Elsewhere, we have a Norges Bank meeting today. Consensus has shifted towards a 50bp hike - taking the policy rate to 1.75%. Though [we think a 25bp move could still be on the table](#). A 25bp would disappoint markets now, though we expect any correction in EUR/NOK to 10.00 will meet good selling interest.

Chris Turner

In Hungary, the central bank will decide on the 1-week deposit rate at its regular meeting today. Normally this would be a non-event but given this week's sell-off in CEE FX markets, which has been particularly painful for the forint, a rate hike is expected to be in play. Yesterday's EUR/HUF peak of around 408 probably raised expectations in the markets of a hike in the 1-week deposit rate, however, the later calming of the situation and the return of the forint below 404 makes a more comfortable situation for the NBH today. Therefore, we see the chances of a stable or higher deposit rate as evenly balanced. However, the risk for the forint is clear given financial market expectations. In the case of unchanged rates, we can expect further forint depreciation.

Frantisek Taborsky

➔ GBP: No real signs of fiscal risk in sterling

Sterling had a wild ride yesterday as a [slightly stronger than expected CPI reading](#) triggered a huge 25-30bp upward adjustment in the Bank Rate expectations curve and a sharp sell-off in the UK Gilt market. UK 10-year Gilt yields rose 16bp yesterday - concentrating minds that the Bank of England will start selling Gilts from its portfolio in September.

Sterling briefly rallied on the rise in money market rates but ended the day net weaker. We were wondering whether fears over the spending plans of prospective Tory PM - Liz Truss - were driving Gilts and effectively putting a fiscal risk premium into sterling. But the UK's five-year sovereign credit default swap continues to trade at a very narrow 17bp - suggesting these fiscal concerns may be overplayed.

We are more in the camp that BoE rate hikes can see sterling confound some of the more dire predictions about its path ahead. And EUR/GBP could again return to the 0.8400 area.

Chris Turner

⬇️ EGP: Egyptian pound could devalue again at any time

There is plenty of speculation about the potential for a further devaluation in the Egyptian pound (EGP) following a 17% devaluation in March. The central bank governor resigned yesterday (with little explanation, he is now a presidential advisor) ahead of today's policy meeting. Consensus expectations are for a 50bp hike and it may be a good time to announce an FX devaluation, too. More FX flexibility is likely needed to secure more IMF funding, but policymakers are concerned about FX passthrough to inflation, given food and fuel price pressures.

The strain this year has come from a weakening current account, along with foreign investor outflows from local T-bills. Foreign holdings ticked up slightly in June to \$8.4bn but are still down about \$16bn year-to-date. Central bank FX reserves are also down \$9bn YTD, from \$40bn.

Pressure on the EGP is being witnessed through the Non-Deliverable Forwards market, where 3m implied yields for EGP are now 45%, pencilling in outright levels for USD/EGP over 21 in three months' time.

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