

FX Daily: Too early to call for an end to the USD run

The re-pricing of global recovery expectations may remain a key narrative in markets as more evidence of rising contagion waves is set to fuel concerns about new lockdown measures and their economic impact



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➔ USD: Not the end of the rally just yet

Pro-cyclical currencies started finding some respite as US equities showed signs of life yesterday and the dollar faced a correction after a week-long rally. Equity futures point at a positive open both in Europe and the US, which could keep the dollar in check for today and possibly keep activity currencies bid.

In the EM space, the decision of FTSE Russell to include Chinese bonds in its benchmark index is offering some support to CNY and helping Asian currencies outperform most other EM currencies. While it is tempting to call for the end of the USD run as the risk environment appears to be stabilising, caution is warranted.

The re-pricing of global recovery expectations may remain a key narrative in markets for longer as more evidence of rising contagion waves (in particular in Europe) is set to fuel concerns about new lockdown measures and their economic impact. We still think the Fed's readiness to intervene if market sentiment falls much further puts some limit to the dollar's ability to recover, but it is hard

to exclude further USD rallies at this stage as global risk appetite appears to have shifted to a much more cautious stance.

The US calendar today is rather light, with only durable goods orders in focus and some comments by Fed's Williams.

⬇️ EUR: Virus fears weighing

Europe is now the key hotspot for a second Covid-19 wave and markets are likely expecting more restrictions to be imposed soon by some European countries.

The EUR may therefore keep lagging most G10 currencies moving into the weekend as investors await more virus-related updates.

This morning, ECB's Villeroy and Hernandez de Cos will speak at an online event, but the calendar shows no more highlights for the rest of the day.

➡️ GBP: Brexit risk remains intact

UK Chancellor Rishi Sunak's new wage-subsidy plan has probably contributed to keeping the GBP supported yesterday as Brexit-related sentiment does not appear to have progressed or regressed after a week of negotiations.

GBP's downside risk still looks quite material as chances of no-deal remain relatively high.

➡️ TRY: Looking beyond the rate hike

The central bank of Turkey's surprise rate hike gave a push to TRY yesterday, but it's the Bank's next steps that will be key for a meaningful and sustainable improvement in the exchange rate. The current level of policy rate at 10.25% seems to be still low in comparison to both actual and expected inflation and Turkey should offer a real positive interest rate so as to reverse dollarisation and improve the capital flow outlook.

Given this backdrop, if the CBT shifts its funding gradually to 1-week repo facility again - as it used to do before the summer - and allows the effective cost of funding to stay broadly flat at its current level of 10.7% in the near term (or decline to 10.25%), the TRY outlook will likely remain fragile.

Still, a continuation of liquidity tightening should provide additional support to the TRY.

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