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FX

FX Daily: Dollar soft, US policy in spotlight

The dollar opens the week on a soft footing as the market awaits fresh policy updates from the White House. These include economic D-Day for Iran and perhaps some kind of US fiscal consolidation plan promised after stress in the Treasury market last week. Most paths seem to lead to a weaker dollar, but Kevin Warsh s speech on Friday could prove supportive.

There may still be room for further USD long-squeezing, and we remain reluctant to call the bottom in this dollar selloff just yet

USD: US economic policy in focus

It has been a quiet start to the week in Asia, but the dollar remains near its recent lows. We made the point last week that we tend to favour a more pro-risk, benign dollar decline than some, but there are many in favour of sharper dollar losses on a return of the 'debasement' trade. That could be tested later today, with US Treasury Secretary, Scott Bessent, announcing a new set of sanctions on Iran. With a new chapter in the US-Canada trade war opening up over the weekend, the question will be to what degree the new sanctions on Iran threaten US trade ties with China again, where China remains the largest buyer of Iran's energy imports. Given the febrile mood in the market and positioning, a big re-escalation in the tariff war is probably a dollar negative.

The other big US policy announcement in focus is the prospect of fiscal consolidation dangled by Bessent last week. Given Washington's firmly pro-growth mind-set, few expect any substantial spending cuts or tax rises, with the burden probably placed on efficiency gains. Clearly, the US Treasury market is not out of the woods yet and this week the focus will also be on Thursday's $44bn auction of seven-year Treasuries.

Also, important this week are Wednesday's release of US core PCE inflation for July and Friday afternoon's keynote speech from Kevin Warsh at the Jackson Hole symposium. While he is unlikely to shed much/any light on what the Fed will do with monetary policy next month, he will have to double-down on the Fed's inflation-fighting credentials - this after his July press conference triggered a sell-off at the long-end of the Treasury market. The speech could be a hawkish event risk for the dollar.

DXY dollar index can probably see further consolidation in a 98.50-99.00 range today, with greater risk seen on the downside.

Chris Turner

EUR: Positioning favours the euro

Latest positioning data from the futures market in Chicago points to asset managers and leveraged funds buying euro contracts. The amounts are not particularly large and the data does predate last Wednesday's jump in EUR/USD, but this does serve as a reminder that speculators look quite underweight the euro. This was the same conclusion we drew when looking at the EUR/USD hedging data.

On the calendar this week is the release of the August German IFO tomorrow. Like the Eurozone PMIs, this is expected to continue its recovery after the sharp drop witnessed in March and April.

We do not really see the need for EUR/USD to come back sharply under support at 1.1660/70 today, but last week's break-out area would be the risk if risk assets started to suffer. At present, we are happy with our current forecasts for EUR/USD at 1.17 end September and 1.18 for end year - but will be reviewing those this week.

Chris Turner

CAD: Trade war escalates

Trade negotiations between the US and Canada have temporariliy broken down, with both sides re-imposing tariffs on the other. As a smaller, more open economy, Canada has more to lose from this, but Prime Minister Mark Carney seems to have opened the door to more fiscal stimulus to support affected business.

After a very strong run recently, the Canadian dollar has come under some pressure. The correction in USD/CAD could extend to the 1.380/3910 area, but we suspect USD sellers will return there.

Chris Turner

TRY: CBT restarts one week repo operations

In some welcome news out of Turkey, the Central Bank of Turkey announced over the weekend that it would be restarting the one-week repo operations. This means that funding operations switch to the 37% policy rate and away from the 40% overnight lending rate. Recall that the one-week repo operations were suspended in early March at the outbreak of US-Iran hostilities and the CBT effectively delivered a 300bp rate hike.

A return to more traditional funding policy looks to be a sign of confidence from local policymakers. TRY short-dated implied yields have dropped on the news and those positioned in the carry trade, expecting the lira to outperform the forwards, will likely stay invested.

Chris Turner

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

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