# FX Daily: Risks skewed towards a stronger dollar in Jackson Hole day

We expect the dollar to find some support if Powell simply endorses the prospects of a fall tapering as the Delta-variant impact is somewhat downplayed. The risks of a de-linking between tapering and tightening prospects are quite material now, but given the non-aggressive pricing for Fed hikes, this should limit, but not invert, any dollar rally.

Source: Pexels

## USD: Many factors to watch in Powell's speech

The dollar has recovered some losses in the two days leading to Fed Chair Powell's speech at Jackson Hole scheduled for today at 15:00 BST, although we suspect the vicinity to such a big risk event will keep volatility in major FX crosses extremely subdued in the hours before the speech. While the Jackson Hole Symposium will dictate most market movements today, it will still be worth keeping an eye on Afghanistan given the rapid deterioration in the security situation in Kabul.

In summary, the FX reaction to Powell's remarks will likely depend on his tone on: a) the US economic growth in light of the Delta-variant spread; b) the timing and length of tapering; c) any guidance on when the hiking cycle will start.

On the first point, the spectrum of likely outcomes span from a very concerned tone on the impact of the Delta variant, with possible hints that the Fed will have to revise its growth forecasts lower, to a very upbeat stance that substantially downplays the potential drag from the new Covid wave and signals the FOMC forecasts will likely remain untouched. Here, the dollar reaction should be the most straightforward: an optimistic tone should see USD rally across the board and a cautious stance should see USD fall and the likes of JPY and CHF likely reap most of the benefits as risk assets may also take a hit.

On the two second points, which will naturally be linked to the assessment of growth prospects, gauging the hawkishness/dovishness of the remarks may not be so straightforward, as a narrative of the Fed de-linking tapering and tightening might emerge. In short, Powell may signal that the tapering will indeed start in September or sometime this fall, but could provide hints that the Fed will be more patient when it comes to starting the hiking cycle. Such combination could put a limit to any post-Powell dollar rally, but it shouldn't be enough to prompt a USD fall considering that the market pricing for Fed tightening – only 50 bp priced in for the next two years - is far from being aggressive.

We are inclined to think that the drop in the dollar earlier this week was not simply a function of market's rebounding after last week's sell-off in risk, but that also markets have turned somewhat more doubtful on the Fed starting tapering already in September. So, any confirmation of tapering in fall could by itself drive USD higher – and leave EM and commodity FX particularly vulnerable – with any extra bits of hawkishness in terms of guidance around the first hike simply adding more steam to the USD rally.

## EUR: Risks skewed to a move back to 1.1700

July's ECB minutes provided yet another confirmation that policymakers in Frankfurt are nowhere close to discussing tapering. The impact on the EUR was minimal, and EUR/USD is likely to remain only driven by factors external to the eurozone. Today, it will all be about Powell's comments, and as we are inclined to think the dollar may come out stronger from Jackson Hole, we also see a non-negligible risk of EUR/USD testing the 1.1700 support today.

## GBP: Still all about external drivers

The higher sensitivity of GBP compared to the EUR to market risk sentiment has driven EUR/GBP marginally higher yesterday. Today, with yet again no data releases worth noting in the UK, the risks for EUR/GBP appear still slightly skewed to the upside if the Fed confirms imminent tapering, which could ultimately take a toll on activity currencies more than on funding currencies. We could witness a break above 0.8600 today, but we do not see any strong fundamental base to drive the pair sustainably higher for now.

## CAD: Oil correlation dangerous ahead of Jackson Hole

The loonie has rebounded slightly less than other commodity currencies this week, falling yesterday on some modest weakness in the oil market. Interestingly, CAD's 60-day correlation to changes in oil prices is markedly stronger than NOK (which is instead the best performer this week). Today's comments by Powell are likely to have an impact on all asset classes, including commodities, and a negative reaction in crude prices (any hawkish signals from Jackson Hole should not be welcome) may exacerbate the downside for the loonie. As a side story, it's worth keeping an eye on the political campaign in Canada ahead of the 20 September elections. Trudeau announced this week that he will raise taxes for financial institutions if re-elected, but we doubt this has contributed much to CAD's weakness, as we think the loonie will be much more sensitive to any pre-election promises about the oil pipeline projects, as high transportation costs remain a key hindrance to Canadian oil producers' profitability.

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