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FX

FX Daily: Fireworks not guaranteed

Today's speech by Jerome Powell in Jackson Hole has been regarded as a pivotal event for markets. However, Powell may refrain from deviating too much from market's expectations, and a reiteration of data dependency could put off part of the market reaction until next week's payrolls data. Still, a consolidation of the hawkish pricing can help the dollar



Markets will be scanning Powell's speech today from a number of different perspectives

Monday 29 August is a national holiday in the UK, we'll resume publication of the FX Daily on Tuesday 30 August.

USD: Powell may not want to shock the markets (in either direction)

Fed Chair Jerome Powell will deliver his much-awaited keynote speech at the Jackson Hole

Symposium at 1500 GMT today. Yesterday, comments by other Fed officials largely fell on the hawkish side of the spectrum. The arch-hawk James Bullard stressed once again the need for front-loading of rate hikes, suggesting rates should be raised to the 3.75-4.0% mark by the end of this year. The host of the Symposium, Kansas City Fed President Esther George, also said high inflation warrants more hikes, but highlighted the importance of incoming labour data (next week) to determine the size of September's hike.

Markets will be scanning Powell's speech today from a number of different perspectives: inflation, growth outlook, front-loading, and any hint of easing in 2023. All these factors can play a different role in driving the reaction in the FX market, although we see a quite elevated risk that Powell may end up broadly matching the generally hawkish market expectations and avert any significant market shock.

On the inflation side, the speech will take place shortly before the release of PCE inflation numbers for July, which are expected to have eased slightly but remain well above 6%. There's simply not enough evidence or interest by the Fed to sound any less concerned on the inflation picture at this point, and a firm reiteration that additional forceful tightening to curb price pressures could remain at the core of Powell's message today.

Our suspicion is also that today's speech will keep the notion of data dependency well intact, and potentially put off a big chunk of what could have been today's market reaction until next week when US jobs figures are released.

Looking at the implications for the dollar, we think that markets may find enough reason to push their peak rate pricing a bit closer to the 4.0% mark today and stir away from pricing back more than the current 1-2 rate cuts in 2023, which should ultimately offer some support to the dollar into next weeks' payrolls release. We think DXY may touch 110.00 in the coming days, if not today.

Despite not being our baseline case, the downside risks to the dollar are non-negligible today. A more alarming tone on recession and any hints that the Fed will be more considerate when it comes to tightening to avert a major dampening impact on the economy would likely trigger an asymmetric negative reaction on the dollar, considering a rather stretched long positioning and short-term overvaluation, especially against European currencies.

Francesco Pesole

↓ **EUR: Fair value converging to spot?**

Today's price action in EUR/USD should be entirely driven by the dollar reaction to Powell's speech, unless some further developments on the gas crisis story come to the fore. As we expect a moderately dollar-positive impact from Powell, we think EUR/USD may re-test the 0.9900 support.

As discussed in recent research notes, the ongoing short-term undervaluation in EUR/USD is quite significant (around 5%), but a shrinking of the risk premium seems unlikely given the major threats to the eurozone's economic outlook and may instead be triggered by a re-widening of the Fed-ECB rate expectations differential – i.e. with the fair value converging to spot and not the other way around.

[The minutes of the ECB's July meeting](#) released yesterday didn't bring anything new to the table. Interestingly, concerns about a weak euro have become a very central theme within the Governing Council: expect to hear more on this topic from an intensifying ECB speakers activity next week, even though the ECB's ability to offer a solid floor to the euro has proven blatantly limited given the persistence of high energy prices.

Francesco Pesole

↓ **GBP: Still driven by external factors**

The pound will lack any domestic drivers today, and Cable should move mostly in line with the dollar reaction to Jackson Hole. A break below the 1.1730 lows from earlier this week may well be on the cards on the back of USD strengthening, as 1.1500 (the 2020 flash crash bottom) is no longer looking like a remote possibility.

It will be interesting to see EUR/GBP reaction to today's speech by Powell. We could see a small recovery in the pair in a hawkish scenario where risk sentiment is hit, considering GBP is normally more sensitive to global risk moves, but the low appetite for EUR longs should keep a cap on the pair for now.

Francesco Pesole

↓ **CEE: Zloty testing stronger levels**

Given the completely empty calendar in the region today, the market will wait for the next move at the global level, i.e. the outcome from Jackson Hole. In the meantime, the CEE floaters decided to test stronger levels for the first time in a while, but in the case of the Hungarian forint it was short-lived and we think that even the Polish zloty does not deserve yesterday's gains at this point.

The forint, which has been heavily driven by gas prices, has been pulled back to weaker levels and this is negative news for the zloty as well. However, zloty was supported yesterday by a rise in market expectations for a rate hike and could thus benefit from a rising interest rate differential for the first time in a while. In our view, however, this is not enough and if bets on rate hikes do not increase further, the zloty will revert back to 4.770 EUR/PLN in our view.

However, markets are already expecting more than a 50bp rate hike at the September National Bank of Poland meeting at this point, which we already think is a very aggressive

expectation given the NBP's dovish rhetoric and worse-than-expected economic data. Therefore, we do not expect the interest rate differential to be supportive of the zloty. Thus, CEE floating currencies remain mainly driven by global influence.

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