FX Daily: High bar for the Fed pivot leaves dollar in ascendancy

It seems the Fed is not particularly displeased with the market reaction to Friday's hawkish Jackson Hole speech from Fed Chair, Jay Powell. Here, real US yields have moved higher, equities have fallen and the dollar has strengthened. Weaker consumer sentiment is unlikely to blow the Fed off course. Elsewhere, look out for a policy meeting in Hungary today

Federal Reserve Chair Jerome Powell at this year's Jackson Hole symposium

USD: Fed applies the brakes, dollar strengthens

We tend to hear it ever more frequently – that a central bank can only control the demand side of an economy and, in an era of dangerously high inflation, its job is to take the steam out of demand. That was a central message in Jay Powell's Jackson Hole speech on Friday (the speech is certainly worth a read). That sentiment has been echoed by newly-minted Fed hawk, Neel Kashkari, who has said that he is 'happy' to see the market reaction since Friday's speech – a market reaction which has included US equity markets falling around 4%.

Our point here is that the Fed policy is designed to slow demand and that (orderly) weakness in equity markets and some softer consumer data (confidence and spending) are not enough to blow the Fed off its tightening course. Looking at US money markets the reaction since Friday has been to price the Fed cycle modestly higher, but also to scale back on the amount of easing expected for 2H23. The pricing of that easing still looks vulnerable as we head into the US August jobs report this Friday.

This environment should keep the dollar bid. As we highlighted recently, the Fed seems quite happy with the stronger dollar and once again we are likely to hear the refrain from US officials that 'the dollar is our currency and your problem'. Indeed, the stronger dollar could be one of the reasons why the ECB could turn more hawkish over the coming months as EUR/USD remains offered near parity.

Dollar strength on the back of higher US real yields is one side of the coin, the other is the energy crisis and other domestic factors weighing on large parts of Asia and Europe. In the spotlight here is China, where USD/CNY has traded up to 6.92, even as the People's Bank of China (PBoC) has protested with stronger CNY fixings. Perhaps USD/CNH traded volatility (one month now 6%) should be even higher than it is today since recent price action points to the PBoC either losing control of the renminbi market or indeed finally shifting to a more flexible FX regime – both of which should deliver more realised volatility.

Heavy positioning is probably the biggest challenge to a further dollar advance. Other than that it is hard to fight against dollar strength. For today, look out for US Conference Board consumer confidence. Lower gasoline prices have consensus expecting a bounce here. But as above, we doubt even a softer number does much damage to the strong dollar story.

DXY probably finds demand under 108.50.

Chris Turner

EUR: Release the hawks

EUR/USD has been finding some support near 0.9920 but remains vulnerable. On Friday we saw a Reuters source story suggesting that a 75bp hike could be discussed at next week's ECB rate meeting – yet even that source story seemed to admit that a 75bp hike was unlikely.

On that subject, today we hear from a few ECB hawks – most notably from Austrian ECB official, Robert Holzman. He has already aired views on the 75bp hike for next week and should repeat those today. Markets now price a 63bp ECB hike on 8 September – we expect 50bp. And the market also prices 160bp of ECB tightening by year-end, which again looks far too much according to our eurozone macro team.

Also, look out this week for natural gas prices. These corrected sharply in Europe yesterday. But whether Russia restarts gas flows via Nordstream 1 after three days of maintenance (starting tomorrow) will be a major driver of gas prices and also of the European currency complex this week.

EUR/USD should remain offered in a 0.9900-1.0100 range this week.

Chris Turner

GBP: Soft equity environment is not helping

Sterling has been a little weaker than we thought, especially against the euro. Sterling typically shows higher correlations to equity markets than the euro (probably given the larger role of financial services in the UK economy). A tough environment for equities is therefore a real headwind to any sterling recovery. 0.8575/85 looks the obvious near-term target for EUR/GBP, while for GBP/USD it remains hard to fight a move to 1.15.

Chris Turner

CEE: Temporary relief for the region

Today, we will see the second release of GDP in the Czech Republic, which should show details of the surprisingly strong growth in the second quarter. Also, there will be a monetary policy decision from the National Bank of Hungary later today. We are expecting 100bp in line with surveys, however this may not be enough for the markets. Polish GDP and inflation data will be released on Wednesday. While the second estimate of GDP should explain the surprisingly negative 2Q result, inflation for August could fall slightly on a year-on-year basis. On Thursday, we will see a pack of PMI releases in the CEE region. Previous months have already shown significant declines and no improvement can be expected this time either. On the other hand, the recent German print sent a positive signal that the decline in sentiment could stop in August.

On the FX front, pressure from EUR/USD and gas prices eased yesterday and CEE currencies can take a breath. However, we do not expect a trend reversal this week and remain bearish for the region. We see the Polish zloty as the most vulnerable given the zloty is at its strongest levels in 10 days, the weak economic data and again the dovish tone of the National Bank of Poland. Thus, we see room to move back into the 4.760-4.780 EUR/PLN range. The Hungarian forint should be closer to 409 EUR/HUF, but today's central bank meeting will be the main driver. The Czech koruna escaped the Czech National Bank intervention levels after a few days, however, thanks to recent dovish statements from the central bank, we believe that the increase in market expectations is only temporary, and the koruna will return to 24.650 EUR/CZK.

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