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FX

## FX Daily: Lagarde faces a harder test than Powell

The world's two most prominent central bankers are both speaking at Jackson Hole today. The dollar has strengthened into the risk event and we think a hawkish tone by Powell is now largely priced in. Lagarde has to deal with a worsening economic outlook in the eurozone, but we suspect she will stick to data dependency and a hawkish tone. EUR/USD can rebound



All eyes are on ECB President Christine Lagarde this week

*Monday 28 August is a national holiday in the UK. We will resume publication of the FX Daily on Tuesday 29 August.*

### ↓ **USD: Powell hawkishness looks largely in the price**

Some Fed speakers laid the groundwork for today's keynote speech by Fed Chair Jerome Powell at the Jackson Hole Symposium. This bulk of Fed speak comes after a rather quiet summer in central bank communication. A couple of standouts from yesterday's remarks: Patrick Harker (2023 voter) leaned on the dovish side and said that the Fed has "probably done enough" on policy tightening. Susan Collins (non-voter) also suggested the Fed may have to hold for some time but refrained from signalling where the peak is. We also heard from former Saint Louis Fed President James Bullard, who stuck to his usual hawkish rhetoric. Bullard's successor is still to be named, but the St. Louis seat is not going to be voted for until 2025, so the impact shouldn't be imminent.

So, what's on the agenda for Powell today? Arguably, the backdrop has not changed dramatically since the FOMC rate announcement a month ago. The disinflation process has progressed in line with expectations, while key activity indicators have continued to prove resilient. Surely, the rather substantial revision in payrolls suggests a less rosy picture for employment than originally indicated, but we doubt that could be enough to trigger a change in the overall policy communication.

Powell will once again have to deal with his own Committee's projections that see rates being raised one last time this year: he will probably reiterate the Fed is open to such a possibility and retains a data-dependent approach. Markets will hardly be surprised by that, or by any restatement that rate cuts are still a long way out.

The recent rise in US rates is surely complementing the monetary-policy-induced tightening of financial conditions, but given the stabilisation in the bond market following the July-August big sell-offs, we don't think Powell will be overly concerned about prompting fresh UST weakness.

The recent firmness in the dollar probably factors in some of the markets' expectations for a hawkish tone by Powell, so we don't expect another USD rally today. Christine Lagarde's speech may have a greater impact on the euro (as discussed below) and cause a DXY correction.

*Francesco Pesole*

### ↑ **EUR: Lagarde can give the euro some relief**

ECB President Christine Lagarde probably faces a harder task than her US counterpart today. The latest PMIs confirmed the [eurozone economy is heading towards a period of sluggish growth](#), which now makes any hawkish statement a harder sell.

At the same time, Lagarde and her ECB colleagues are probably aware that the window for one last hike to curb the still non-negligible service inflation is closing fast. In other words, if the

ECB pauses in September, it may well not get a chance to hike any more given the deteriorating economic outlook.

As in the case of the Fed, we have already heard from a couple of ECB speakers. Ultra-hawkish member Joachim Nagel unsurprisingly said it's too early to think about a pause and restated the bank's data-dependent approach. A slightly more moderate Governing Council member, Boris Vujcic, also echoed such reasoning.

Our perception is that Lagarde is unhappy with the market's recent scale-down of rate expectations in the eurozone (a September hike is only 40% priced in), and she may prefer to keep overlooking some evidence of worsening growth and stick with a pure data-dependent approach. Ultimately, if inflation surprises on the upside, the chances of a hike in September would rise quite significantly in our view, especially given the deteriorating growth outlook, which means that could be the ECB's last chance to raise rates.

The EUR-USD two-year swap rate differential has widened (in favour of the dollar) to the 140-145bp levels, which were last seen in February/March. We think there is room for some re-tightening after Lagarde's speech today, and for EUR/USD to enjoy a relief rally after the break below 1.0800 saw more bearish momentum building overnight.

*Francesco Pesole*

### ➔ **GBP: Broadbent speaks tomorrow at Jackson Hole**

Ben Broadbent is the only Bank of England member speaking at Jackson Hole, but his remarks are scheduled for tomorrow, so we'll need to wait for Monday to see any impact on sterling. The recent volatility in the BoE peak rate expectations on the back of data releases (wages, inflation, retail sales, PMIs) means the return of some BoE comments after a long period of silence can definitely move the market. It's worth noting, however, that UK markets are closed on Monday for a national holiday so volumes will be thinner.

For today, the pound will be moved by Powell and Lagarde. We think Cable should find good support around 1.2500 in the event of more USD strength, while EUR/GBP can extend its rally beyond 0.8600 if we are right about Lagarde sounding hawkish today.

*Francesco Pesole*

### ➔ **JPY: Tokyo inflation slows**

Inflation figures for Tokyo were released overnight, showing a deceleration in price pressures which were in line with the Bank of Japan estimates and slightly below consensus. Inflation in the capital moved below the 3% mark in August for the first time since September 2022, essentially endorsing the BoJ's reluctance to scale back monetary easing.

USD/JPY has risen steadily in line with rebounding US treasury yields since yesterday's early session when it touched a 144.50 low. We think that a hawkish tone by Powell is largely priced in today, but should be enough to keep USD/JPY around 146.00 for today.

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