FX Daily: The art of saying nothing

There is often greater value in saying too little than too much in central bank communication and a market that is already pricing in a 50bp Fed cut by December may prompt Chair Powell to avoid strong guidance today at Jackson Hole. The dollar might like it, but the impact should be short-lived. BoE Governor Bailey's speech may give away even less guidance

Fed Chair Powell and Bank of England Governor Bailey

USD: Cautious Powell may give some help to the dollar

The latest batch of US data has not firmly argued in favour of a 50bp Federal Reserve rate cut in September, and most FOMC members have also appeared to moderately push back against that prospect in recent off-meeting comments. Yesterday, US services S&P Global PMIs were stronger than expected and compensated for another decline in manufacturing, while initial jobless claims rose only slightly, in line with consensus, to 232k. Continuing claims – a measure of the difficulty of re-entering the workforce – were less than expected and were revised lower for the previous week.

The payroll revisions published earlier this week showed the jobs market is loosening from a weaker position, but other activity/jobs indicators are not flashing amber, which should allow Fed Chair Jerome Powell to keep communication relatively balanced as he speaks at Jackson Hole today (1500 BST). He will probably use this speech to prepare markets for a September cut, which is entirely priced in and has been largely anticipated by July's Fed minutes and recent Fed speakers. The question is whether he will go as far as opening the door to a 50bp move – if not in September, at a later point this year.

When looking at market pricing, there is probably not much incentive to open the door to a 50bp move at this stage. 100bp is fully expected over the next three meetings, and the market tendency to price in more aggressively on the dovish side means hints of half-point moves could take the Fed funds futures curve uncomfortably low for the Fed. It appears more likely that Powell will re-emphasise the focus on both sides of the mandate, reiterating data dependency and effectively putting off any further big move in rate expectations to the 6 September payrolls data (barring a PCE shock).

The risks for the dollar are slightly upside-tilted today in our view. That said, we don't expect Powell's speech to have long-lasting ramifications for FX, and we retain a bearish bias on USD in the near term as the rebuilding of speculative positions following the recent rebalancing still looks more likely to favour dollar shorts.

The yen enters today's risk event with decent momentum, having appreciated over 2% in the past seven days. Overnight, Bank of Japan Governor Kazuo Ueda maintained a generally hawkish tone in a likely attempt to show independence from the recent turmoil in the Japanese stock market. Further rate hikes are on the table, and the marginal CPI surprise (2.8% vs 2.7% year-on-year) this morning is also helping the hawkish case. Markets remain relatively hesitant about a move by year-end though, with only 10bp priced in by December. We think the chance of a hike is – once again – underpriced. Today, USD/JPY may trade higher on Powell's cautious tone, but the path forward remains downward-sloping for the pair, in our view, as the pressure on the yen from carry trades looks unlikely to build up again into a Fed cut.

Francesco Pesole

EUR: Chance of retesting 1.1100

French CPI surprised yesterday, but the global investor community quickly agreed this was down to a short-term boost to services from the Olympic games, which translated into a likely spurious boost in the eurozone-wide surveys. The news from Germany was instead quite grim, as both manufacturing and services slowed more than expected and the composite index fell further into contraction to 48.5.

We have repeatedly highlighted how that does not matter hugely for the euro as long as inflation and wages prevent large cuts from the ECB. The Bank's own measure of negotiated wages slowed from 4.7% to 3.6% in 2Q, but swap rates and the euro did not really react to the release as German wage data released earlier this week painted a much more worrying picture, and there is a strong suspicion the decline in eurozone negotiated wages might be due to one-off factors. Incidentally, the PMI report showed German output charge inflation was the highest since February.

Markets remain comfortable with pricing slightly less than one cut per ECB meeting by year-end (69bp in total), and things may not change until the next batch of key data releases move the needle again. EUR/USD has room to climb in the coming weeks, but investors may use an unexciting Powell speech today to lock in some profit and have the pair re-test the robustness of the 1.1100 support. The ECB CPI expectations report this morning is expected to show a marginal decline from 2.8% to 2.8% in the one-year gauge, and may not move the market significantly.

Francesco Pesole

GBP: Don't expect much from Bailey

Bank of England Governor Andrew Bailey speaks today in Jackson Hole (1600) and we think he may emulate Powell's approach in saying as little as possible. Bailey does not have to deal with aggressively dovish pricing (-39bp by year-end), but the UK still needs to gain much more confidence on the inflation front.

August has not really seen many remarks from BoE policymakers: the latest ones were from a hawk, Catherine Mann, who once again emphasised the risks of structural wage-price inflation. Before then, it was Chief Economist Huw Pill who spoke on 2 August and said the BoE shouldn't be promising rate cuts in the very short term.

There is a good chance Bailey's speech will be a non-event for sterling. EUR/GBP has returned below 0.8500 on the back of eurozone-UK growth differentials, but we remain wary of chasing the pair lower given the rate-spread picture. A rebound to 0.8550-0.8600 remains our call for the coming weeks.

Francesco Pesole

CEE: Well protected against the risk-off switch

With the exception of Hungarian labour market data, the calendar is empty for Friday in the region. Even so, the focus shifts to the global story and news from Jackson Hole. Yesterday's EUR/USD reversal already visibly hurt CEE currencies. However, local rates still kept pace with rising core rates and with weak summer liquidity, the market remained almost unchanged. For today and Monday, we see a rather bearish outlook for the CEE region given the market's caution on Fed cuts and switching into risk-off mode. Still, CEE is outperforming the emerging market space, and given the rather dovish market expectations in the region and higher EUR/USD, CEE currencies should be supported and maintain at least current levels, with more gains later. The main focus should be on EUR/HUF, which usually sets the tone for the National Bank of Hungary meeting, scheduled for Tuesday next week. Although we do not expect a rate cut this time despite the low EUR/HUF levels, the main question is still whether the next meeting in September is live.

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