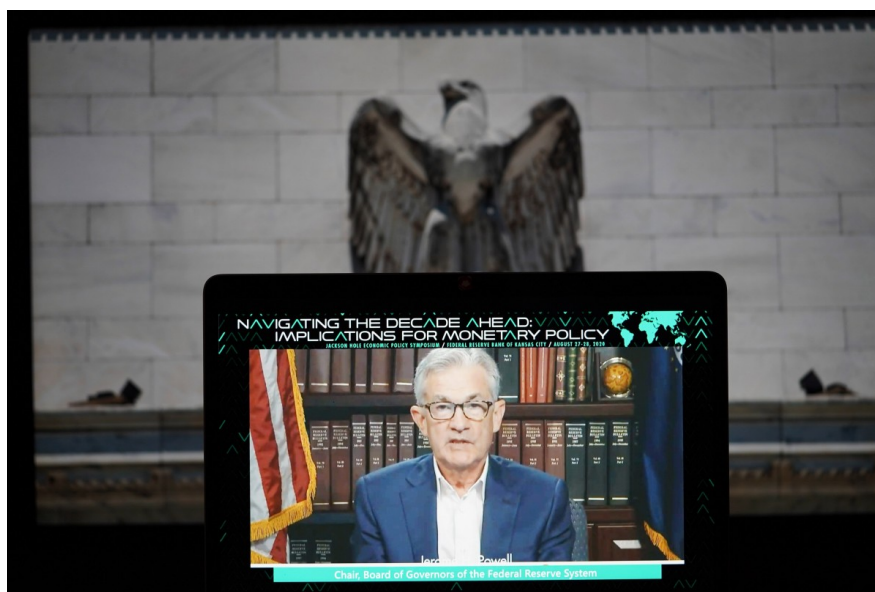


FX Daily: USD to remain weaker for longer

As the Fed adopts average inflation targeting, we think interest rate hikes are very unlikely to happen in the near future and USD real rate will remain low and could even go (initially) lower if the Fed succeeds in generating higher domestic price pressures



Federal Chairman Jerome Powell delivering a speech to the Kansas City Fed's annual Jackson Hole research conference, which is held virtually this year because of the pandemic.

Source: Shutterstock

↓ USD: Weaker for longer

Fed Chair Jerome Powell formally announced yesterday the [adoption of average inflation targeting](#).

The adoption of average inflation targeting and tolerance for inflation to overshoot and make up for prior undershoots suggests (a) interest rate increases are a very distant proposition, and (b) USD real rate will remain low and should even go (initially) lower if the Fed succeeds in generating higher domestic price pressures.

This points to a bearish USD outlook for many quarters to come (indeed, USD weakened across the board overnight). The scope for prolonged USD weakness and the non-tightening Fed should be also beneficial for emerging market currencies, particularly if it will take time for US inflation to start persistently overshooting the 2% target and the curve steepening will remain moderate as this would make local EM bonds attractive -unhedged -and keep inflows into EM markets in place.

📈 EUR: Going with the flow

Like other G10 crosses, EUR/USD has been benefiting from the post Powell speech USD weakness. While much good news is priced into EUR and speculative positioning is stretched, dollar weakness is likely to dominate. August eurozone confidence indicators should tick higher today, helping EUR/USD to keep its gains.

📈 JPY: Reports of Abe's resignation add to USD/JPY downside

JPY received a modest boost overnight from reports that prime minister Shinzo Abe plans to resign.

Abenomics was one of the key ingredients behind the JPY weakness in prior years. But what also matters for JPY is the central bank's stance and it may be too early to conclude that an Abe resignation would lead to a material change to the BoJ stance, particularly when all major central banks have increased their easing bias in recent months.

Nonetheless, concerns about the post-Abe shift in the policy stance add to our bearish USD/JPY outlook (we target USD/JPY 102 by year-end), though we continue to see USD weakness as the main driver of the cross.

📈 CAD: 2Q slump no worse than others

In Canada, the market is looking for a c.40% slump annualised in 2Q GDP, which would mean a peak to trough fall of c.13.5%. Given the issues in the oil market earlier in the year with negative pricing and the fallout for producers, such a GDP reading would be a relatively respectable outcome.

CAD's recent resilience should remain intact in the coming days.