

FX Daily: September Fed conundrum remains

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We read yesterday's PCE print as benign enough to stick to our call for no Fed hikes this year. But markets are still hawkish, and the risk is that the FOMC may be drawn into a hike by market pricing, if only to avoid triggering bond volatility. Tomorrow's speech by Chair Kevin Warsh could be pivotal. Meanwhile, CAD and AUD are on very different trajectories

USD: Wait and see ahead of Warsh's speech

Data releases in the US yesterday were a mixed bag, offering some support to the dollar but failing to solve the market's conundrum about the September FOMC (pricing now 9bp). Core PCE, the Federal Reserve's preferred inflation gauge, printed in line with expectations at 0.2% month-on-month and 3.3% year-on-year, suggesting disinflation remains on track but at a frustratingly gradual pace. Headline PCE came in slightly firmer at 0.2% MoM and 3.7% YoY, prompting a small hawkish repricing in the USD curve.

The growth side of the report was softer. Real personal spending was unchanged in July despite higher real disposable income, with households opting to save rather than spend. Real household disposable income has effectively flatlined for more than a year.

Overall, we remain reasonably confident in our call for the Fed to hold on 16 September and, by extension, in a weaker dollar. That said, the next three weeks may need to bring a more convincing combination of data and Fed speak before markets move closer to a hold outcome. Our concern is that, if markets are pricing roughly a 50% chance of a hike by decision day, the likelihood of a hike would increase, as the Committee may be reluctant to risk triggering bond market volatility.

Tomorrow's speech at Jackson Hole by Kevin Warsh remains a potentially pivotal event for FX, and markets may be reluctant to build excessive USD shorts today. DXY may find support above 99.0 into the speech despite some upbeat risk sentiment after strong Nvidia results.

On a separate note, we discuss why we think CAD has further to fall, especially in the crosses, on the back of the latest US-Canada trade tensions [here](#).

EUR: Not touched by Russia headlines

Energy prices inched higher yesterday after a report suggested the Kremlin is planning a new escalation in the Ukraine war after negotiations for a peace deal reached an end. Reportedly, that could mean an intensification of conventional ballistic missile strikes.

The Russia-Ukraine conflict has been completely sidelined by markets for a while, and there was little to suggest hopes of a resolution were building up. The commodity markets continue to look only at the Middle East situation and it's too early to draw any conclusions for the euro from yesterday's headlines.

The eurozone data calendar is quiet today, and EUR/USD can stabilise around 1.1640-70 ahead of Warsh's speech at Jackson Hole. On politics, it's worth keeping an eye on the first French presidential debate. Marine Le Pen is currently leading in the polls.

JPY: Tokyo CPI shouldn't change hawkish views

Tokyo CPI for August is released at 00:30 BST tomorrow. The headline is expected to inch lower to 1.9% (from 2% in July) and core to 1.8% (from 1.9%). A close-to-consensus print should not derail market confidence on a rate hike by the Bank of Japan on 18 September (21bp currently in the price), after US Treasury Secretary Scott Bessent called for a policy follow-up to FX intervention and July CPI surprised on the upside.

The two-year USD:JPY swap rate differential has shrunk by around 35bp in the past 30 days, but the yen has failed to attract buyers below 158. With a lot of BoJ tightening in the price, the risks are that officials disappoint markets on the dovish side even if they hike in September. Ultimately, a dovish Fed repricing remains the most tangible path to keep USD/JPY below 160.

AUD: We are still leaning towards a hold despite hot data

The Aussie dollar is the only G10 currency gaining ground this week amid a broad USD rebound. Hotter-than-expected inflation for July (3.5% headline, 3.6% trimmed mean) has caused a rapid rebuilding of hawkish expectations, with markets now pricing in a 28bp by year-end. That's around a 15bp jump since the start of the week.

This morning, Australia reported very strong household spending data for July (7% YoY), further helping the case for more tightening. However, our macro team is still leaning towards a prolonged hold by the Reserve Bank of Australia, but we admit the hawkish risks have increased.

House prices are declining and unemployment has edged higher, trends that should become clearer in the 2Q GDP data. Moreover, the Reserve Bank of Australia will likely wait for another set of quarterly numbers before concluding that the pickup in inflation is anything more than a one-off. Ultimately, we expect the inflation trajectory to prove benign enough to avert another hike, with our call for a Fed on a prolonged hold also diminishing any sense of urgency in Australia.

Markets are pricing in 12bp for the 29 September meeting, and we expect that pricing to be unwound, limiting AUD gains for now. Our view on AUD/USD remains upbeat into year-end with a 0.730 target, but that's relying on our dovish Fed call, which should have a net-positive impact on the pair even if a dovish repricing in the AUD curve happens.

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