SMBC Capital Markets, Inc.

fxPoetry

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Not Yet Completed

The Fed has a Chairman named Jay
Whose hogged the attention today
The question at hand
Can he and his band
At last hold inflation at bay

His minions have, lately, repeated
The process is not yet completed
And that means more hikes
Which nobody likes
To tackle this, problem, deep-seated

While we will, in fact, get data of note this morning, specifically Personal Income (exp 0.6%), Personal Spending (0.5%) and PCE (6.4%, 4.7% core) at 8:30 and then Michigan Sentiment (55.4) at 10:00, that is still secondary to the current game of guessing what Chairman Jay is going to tell us. And for now, nothing else really matters.

Yesterday we heard from a number of other Fed speakers, and they all explained that the job was nowhere near done. The hostess of the Jackson Hole event, KC President Esther George explained that the Fed "***should raise rates until evidence inflation is coming down***" and ***"we have more room to go in raising rates***." She finished by explaining it is, "***not out of the question that Fed would hold rates above 4%***" and "***we want financial conditions to tighten***." That seems like pretty clear direction.

Then we heard from Philadelphia's Patrick Harker who explained, ***"Fed needs to raise rates to restrictive stance,***" and that he "***would like Fed rates above 3.4%, then maybe sit a while***." He has "***not decided yet on 50bps or 75bps at September FOMC meeting"***, but ***"doesn't feel like a recession given the strong job market***." He concluded by repeating he "***wants monetary policy at restrictive stance***." Once again, it feels like this is consistent with, albeit maybe not quite as aggressive as, Esther.

Before we heard from our next speaker, St Louis President James Bullard, the KC Fed Manufacturing Index was released at a much softer than expected 3 (had been expected at 10), thus giving another survey data point of weakness that has not yet fed into the hard data.

Of course, by this time we know that Bullard has refashioned himself as an uber hawk so his comments are not very surprising at all. He repeated he "***favors getting rates to 3.75%-4% this year***," and that the "***Fed may have to be higher for longer***." He repeated his desire to frontload rate hikes and explained he doesn't pay much attention to signals from the equity markets. He was clear that "***rates aren't high enough now. [the Fed] need to get the policy rate to where it pushes downward pressure on inflation***." And finally, he explained his "***baseline is that inflation will be more persistent than what many expect."*** Once again, this seems pretty clear as to what he believes is needed and what the Fed is going to do.

And with that as intro, Chairman Powell takes to the microphone at 10:00am EST. While it seems unlikely to me that he will speak specifically of the September meeting, I expect, along with many others, that he will maintain that the job is not nearly done and that they remain highly focused on returning inflation back to their 2% target even if that means a recession occurs. Of course, he will also explain that a soft landing is still likely, but I fear that is simply wishful thinking. He knows that every word he utters will be parsed like your 8th grade English teacher did your book reports, and so I'm pretty sure he is going to do his best to say as little as possible. Remember, the title of the symposium is: Reassessing Constraints on the Economy and Policy, not the most exciting sounding topic, and he will try to focus some attention on that, but the reality is that the only thing of interest are his views on the Fed's next steps.

With all the focus on Jackson Hole, it is not too surprising that markets overnight have been relatively lackluster. Equities in Asia mostly followed yesterday's US rally (Nikkei +0.6%, Hang Seng +1.0%, Shanghai -0.3%) but Europe is under some pressure (DAX -0.4%, CAC -0.4%, FTSE 100 0.0%). It is a bit surprising that the UK is faring best given the news from Ofgem (office of gas and electricity markets) that the price cap for energy was raised to £3,549 come October, an 80% price hike and a level more than triple 2021 prices. It is little things like this that have driven the calls that inflation in the UK will reach 18.6% by the end of the year, and yet the equity market has held its own. As to US futures, they are lower across the board by roughly -0.4%.

Bond yields are higher everywhere with Treasuries (+4.7bps) recouping about half of yesterday's decline with similar price action in Europe (Bunds +2.9bps, OATs +3.6bps, BTPs +9.5bps) and only Gilts (-0.9bps) bucking the trend. Perhaps this is a 'buy the news' type reaction as expectations for that energy price rise could well have been higher.

Oil prices (+1.3%) are back higher again, although have truthfully been range trading for the past month. Looking at the chart (though I am no technician) implies to me that we are forming a bottom before the next leg higher. This fits with what I believe is the structural issue of a lack of supply over time, recession or not. NatGas (+0.7%) is also edging higher and continues to be the most volatile commodity around, but here, too, the trend is very clearly higher and I fear that a move to the all-time highs of $14/MMBtu is within reason as we go forward. There is a structural supply deficit that will be felt over time in this commodity as well.

Metals prices show gold (-0.7%) giving up yesterday's modest gains while copper (+1.8%) is starting to take on a life of its own and is now a solid 20% off its lows. Aluminum (+2.9%) is also faring well today.

Lastly, the dollar can only be described as mixed this morning, with a similar number of gainers and losers vs. both G10 and EMG counterparts. The euro (+0.3%) is today's top performer, although I would say that has less to do with any news from Europe, than with positions being adjusted ahead of Powell's speech. On the other side of the coin is NZD (-0.3%) and JPY (-0.3%). From Japan we saw Tokyo CPI rise 2.9% in August, 0.2% higher than expected with the core reading higher as well. However, there has certainly been no indication the BOJ is going to change policy. GfK Consumer Confidence in Germany fell to -36.5, the lowest reading in the series' history since 2005, and hardly a sign of confidence. But again, all eyes are on Powell at 10.

EMG currencies saw a bit larger movement (THB -0.5%, ZAR -0.45%, HUF +0.55%, CZK +0.4%) but again, the news has been limited with respect to drivers. Arguably the forint and koruna are simply responding to the euro's strength while the rand and baht, which have been relatively strong of late, seem to be giving back some of those gains ahead of the Powell speech.

And that's really it. If I had to estimate the biggest risk it is that Powell is perceived as more dovish than the market has reluctantly been pricing on the back of the constant discourse of hawkishness by his minions. And that would be bullish for stocks, bonds and commodities while the dollar suffered. But I don't think that will be the case. I have a feeling that he will go out of his way to maintain the hawkish tone to help tighten financial conditions. And so, I expect the dollar will edge higher by the time the weekend arrives.

Good luck, good weekend and stay safe
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