Back to life, back to an inflation reality?

The number one question for bond markets right now is whether missing US inflation over the past quarter has been transitory or transitional

Source: iStock

Theme of the week: US inflation to breathe some life into a nervous USD

It's so quiet that you can almost hear the tumbleweed blowing across markets. Admittedly, it is a bit too quiet for our liking, especially when this week may see the rumblings of US inflationary pressures return – with producer and consumer prices (Thu/Fri) expected to bounce back strongly. The number one question for bond markets right now is whether missing US inflation over the past quarter has been transitory or transitional; robust signs of underlying inflationary pressures in the US – as also observed in the latest wage growth data – will undoubtedly be a wake-up call to bond markets that currently see inflation as being more than just on a summer holiday.

Yet, whether intentional or not, we note that Making Everyone else Great Again (MEGA) has been the White House's influence on FX markets; while part of the USD weakness can be ascribed to a weaker economic outlook, we note that uncertainty over the administration's ability to push through its pro-growth policy agenda, as well as question marks over the US political backdrop, means that we're likely to see some general dollar nervousness in the near-term. Indeed, it'll take more than a few solid data points to overcome this headwind.

Majors: EUR/USD on a tear to 1.20 ahead of Jackson Hole

EUR: Will the 'Europhoria' continue?

- A solid US jobs report has dented any immediate prospect of EUR/USD hitting 1.20 and we think a little more downside could be seen this week. Driving this should be firmer US price data (PPI Thu, CPI Fri), where PMI indices are starting to warn of a slight uptick in US pricing power.
- Some modest uptick in US rates (and quite a negative pattern on the weekly candle chart), warns that EUR/USD could make a run to 1.1650/80. Yet what should be good German IP data should keep the downside limited.

		Week ahead bias	Range next week	1 month target
EUR/USD	Spot ref: 1.1880	Mildly Bearish	1.1680-1.1830	1.20

JPY: Playing the 110-115 range

- $/JPY remains key vehicle to play both: (i) Trump's political travails and (ii) the US growth/rates story. On the former, it's hard to know when the bad news will hit, but with the latter, this week should prove positive for the USD. The US rates curve is very flat & higher US prices should steepen the curve.
- In Japan this week, we'll see surveys on activity (Mon & Tue), June trade & regular portfolio data. We're still of the opinion that Japanese residents should be accelerating foreign bond purchases around now.

		Week ahead bias	Range next week	1 month target
USD/JPY	Spot ref: 110.10	Mildly Bullish	110.10-112.10	115

GBP: Credible BoE rate hike debate more a 2018 story

- The combo of a dovish BoE disappointment and a slightly rejuvenated USD has seen GBP/USD fall back to 1.30; we see near-term risks of a move below here as the BoE's patient policy approach could see GBP take on more of a funding currency role in a diverging monetary policy environment.
- Expect GBP to remain sensitive to UK data outcomes as markets continue to reassess 2017 BoE rate hike odds; Jun industrial production and trade (Fri) to note this week, with both important for any 2Q UK GDP revisions.

		Week ahead bias	Range next week	1 month target
GBP/USD	Spot ref: 1.3150	Neutral	1.2850-1.3150	1.25

Dollar bloc: Noise around OPEC/non-OPEC meeting on output compliance

AUD: RBA talk to shed light on 'positive' outlook

- The Aug RBA meeting noted greater concern over the recent AUD rise (albeit USD related), though the central bank's slightly more optimistic projections have limited any meaningful fallout below 0.80.
- We think a neutral RBA policy bias will remain in place and see limited scope for AUD rates moving higher. Focus will be on speeches by the RBA's Kent (Tue) and Lowe (Fri) for clarity on the inflation outlook, while the data docket sees the latest consumer and business confidence indicators.

		Week ahead bias	Range next week	1 month target
AUD/USD	Spot ref: 0.7970	Neutral	0.7870-0.8050	0.78

NZD: Watch out for ramped up RBNZ jawboning

- The RBNZ meeting (Wed) takes centre stage and while we are not looking for any policy move in 2017, the focus will be on the central bank's appetite for a mid-2018 rate hike. We see some macro evidence to support a slightly more hawkish tone, but softer 2Q inflation and concerns over a strong NZD will likely see the RBNZ stick with a neutral 'wait-and-see' policy stance.
- While we would expect NZ rates to stay steady (slight downside risks), the kiwi could come under pressure from ramped up RBNZ jawboning.

		Week ahead bias	Range next week	1 month target
NZD/USD	Spot ref: 0.7450	Mildly Bearish	0.7300-0.7460	0.73

CAD: OPEC noise to weigh as bullish optimism fades

- A small miss in both Canadian job gains and the Ivey PMI has added to the fading CAD optimism. We see scope for a bigger USD/CAD correction higher as markets have got ahead of themselves in pricing an extensive BoC hiking cycle. Lower short-term CAD rates would fuel a move back to 1.27-1.28.
- The domestic calendar in the week ahead is sparse, with only housing data to note. CAD vulnerable to noise around the OPEC meeting (Mon-Tue) - but oil stuck in the $45-$55/bbl range won't be a big catalyst for the pair.

		Week ahead bias	Range next week	1 month target
USD/CAD	Spot ref: 1.2570	Mildly Bullish	1.2550-1.2740	1.28

European FX: CHF looking a bit leave it

CHF: Soft CPI to support SNB's dovish stance

- It looks as though option market activity might have been the key driver behind the EUR/CHF move to 1.15, yet we have been arguing for a while that foreigners may not need to hold so many CHF - now that Europe is in better shape. A big decline in CHF sight deposits (Mon) would support this.
- Monday also sees July CPI data, expected at just 0.3% YoY. We reiterate that the SNB can defend its super-loose policy given low inflation and softish growth, and will patiently wait for the ECB to drive EUR/CHF higher.

		Week ahead bias	Range next week	1 month target
EUR/CHF	Spot ref: 1.1500	Mildly Bullish	1.1400-1.1500	1.17

SEK: Stuck around 9.60

- EUR/SEK should remain stuck around the 9.60 level throughout the week. Swedish Jun IP (Thu) should correct from the previous months high levels but as this is broadly expected, the impact on SEK should be muted.
- EUR/SEK has been so far resilient to any spill-overs from the ECB QE expectations and this should remain unchanged. Swedish average house prices are set to remain high in Jun (Thu), but with Riksbank preferring to lean against SEK strength the impact on SEK should be non-existent.

		Week ahead bias	Range next week	1 month target
EUR/SEK	Spot ref: 9.6080	Neutral	9.5090-9.6480	1.17

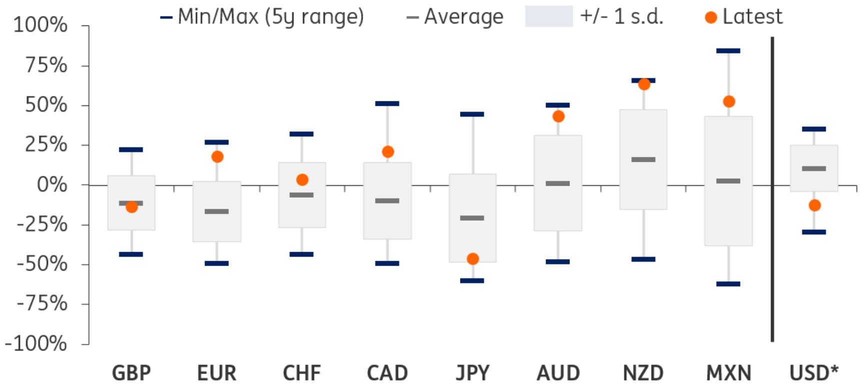
NOK: Drop in July CPI to weigh on NOK

- While a further drop in Norway July headline and underlying CPI (Thu) is unlikely to bode well for NOK, we don’t expect it to meaningfully effect the NB’s reaction function. As the NB looked through the above target CPI period in 2015-16, it should look through the below target CPI now.
- Still, the declining CPI poses an upside risk to EUR/NOK, particularly if the recent rebound in the oil price fades. EUR/NOK to test 9.4000 resistance this week.

		Week ahead bias	Range next week	1 month target
EUR/NOK	Spot ref: 9.3730	Neutral	9.3000-9.4450	9.30

G10 FX Positioning: CAD bullish bets looking extreme

Speculative positioning (% of open interest)



Source: CFTC, ING as of 07 Aug 2017 (data reported with a lag)

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