Back to school: Curb your FX enthusiasm

Central banks return to school from their summer breaks, with investors wondering who's done their currency assignments. But don't we all need a crash-course in Geopolitics 101?

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Theme of the week: Back to school for central bankers

Central bankers return from their summer holidays en masse this week, with policy meetings scheduled in the Eurozone, Sweden, Australia and Canada. The first three on the list will certainly not want to drive their currencies any higher, though benign external conditions are against them. A nonchalant Bank of Canada may surprise markets with a rate hike, though we suspect it may show a more cautious hand this week. Despite the renewed North Korea geopolitical tensions, we don't expect markets to be persistently plagued in the absence of a material escalation. The limited negative spillover into the high-beta currencies - as well as the lack of a broad-based or safe-haven USD strength - provides a case in point.

It'll take some strong US data to break markets from the current weak USD spell. The number of data points to save a December rate hike is decreasing by the week; unless some of the Fed speakers manage to convince markets that rates will be raised in December, the benign external conditions, which includes an orderly fall in the dollar, look set to continue. And noticeably, the dollar has failed to derive any benefit from the return of fiscal stimulus chatter as part of the Trump policy agenda, no doubt because the chances of Congress approving unfunded 'tax cuts' -

as opposed to comprehensive 'tax reform' - look virtually zero.

Majors: Geopolitics unlikely to divert attention away from ECB

The standout event of the week is the ECB meeting on Thursday and with concerns over a EUR overshoot having actually manifested since the July meeting, we expect President Draghi will do his best to tame any material EUR upside

EUR: Draghi tongue-tied on the EUR?

- Thursday's ECB meeting will be the highlight of the week, particularly what President Draghi has to say about recent EUR strength. Even though media reports suggest that EUR strength is causing concern for some Governing Council members - which may lead to possible delays to tapering - we doubt Draghi has enough verbal firepower to talk the EUR substantially lower.
- Friday's US jobs data maintains the positive risk and weak dollar global market backdrop. US data is light this week, but we have a host of Fed speakers that may shed light on whether balance sheet reduction starts in September, and whether they still favour a rate hike in December. Risks are that we see some more cautious policy rhetoric in light of recent US data.

		Week ahead bias	Range for week	1 month target
EUR/USD	Spot ref: 1.1890	Mildly Bullish	1.1800-1.2100	1.20

JPY: Benefiting from geopolitics, but to a diminishing degree

- The North Korea geopolitical tensions over the weekend have provided a boost to JPY. However, unless we see a material escalation of the situation, we don't expect USD/JPY to break the 108.50 level this week given that the extent of headline-driven price moves seem to be diminishing. Greater market nervousness may keep USD/JPY upside contained, while the tail risk of an escalation could easily see a move below our weekly range.
- Trump's re-introduction of his tax reform agenda has understandably had little impact on the dollar ('15% tax cut unlikely to be funded with extra fiscal revenue'). Therefore the best bet of dollar support comes from Fed talk this week, somehow convincing the market that chances of a rate hike in December are above 30%. We see this as unlikely, especially as markets are well-versed in the Fed's reaction function and are accurately tracking US data outturns. Of the Fed speakers next week, it will probably be centrist Dudley's speech on monetary policy on Friday that gains most attention. Wednesday sees the Fed Beige Book released before the Sep 20th FOMC meeting.

		Week ahead bias	Range for week	1 month target
USD/JPY	Spot ref: 109.50	Mildly Bearish	108.50-110.70	112

GBP: Entering a territory that will warrant BoE attention

- After a dismal August, GBP looks to be entering a consolidative phase ahead of the upcoming Bank of England (BoE) policy meeting (September 14). We believe that both a softer UK economic outlook and domestic political risks are adequately priced into the currency now, and only an escalation in either would warrant further idiosyncratic GBP weakness. While BoE officials may state that they are not targeting a specific exchange rate level, we suspect the trade-weighted GBP index around the 74 level - and close to historic lows - is in a territory that will warrant greater attention from policymakers. We wouldn't be surprised to hear greater BoE noise over sterling weakness, primarily in terms of what this means for inflation overshooting the 2% target and whether the growth-inflation policy trade-off has altered for some MPC members. This in itself could provide a backstop to the current GBP-selling environment.
- Services PMI (Tues), house price data (Wed) and industrial production (Fri) are the key releases to note this week. The House of Commons reconvenes after its summer recess and will vote on whether to take the EU Repeal Bill to the next stage (Wed). While the latest round of Brexit talks failed to churn out any meaningful conclusions - unsurprisingly given the obstacle of the German elections later this month - the limited GBP fallout also implies that markets may already be well-prepared for upcoming political event risks.

		Week ahead bias	Range for week	1 month target
GBP/USD	Spot ref: 1.2940	Neutral	1.2850-1.3070	1.26

Dollar bloc: Careless Bank of Canada whispers...

Central bank meetings in Australia and Canada will show a clear divergence in policy stances, though we wouldn't be surprised to see both sets of policymakers chalking up concerns over a stronger local currency

AUD: RBA to reiterate macro risks of a strong FX

- The September RBA meeting (Tue) is unlikely to throw up any major surprises given that we only have Governor Lowe's statement due this month. FX markets will be paying particular attention to the language used to describe the AUD's recent behaviour; we expect no change to the current paragraph that states "an appreciating exchange rate would... result in a slower pickup in economic activity and inflation", though the tail risk is that the Governor explicitly expresses a greater desire for a lower currency. We doubt the latter occurs given that the trade-weighted AUD has moved below the 67 level since the early August meeting.
- On the data front, 2Q Australian GDP (Wed) will be the standout release; the central bank has pencilled in a figure of 1.75% YoY and any surprise in either direction could spur some movement in short-term AUD rates. Retail sales (Thu) and a host of RBA speakers - including Governor Lowe (Tue) - also event risks to note.

		Week ahead bias	Range for week	1 month target
AUD/USD	Spot ref: 0.7950	Neutral	0.7920-0.8050	0.76

NZD: Election run-in to see kiwi trade with a negative bias

- With speculative markets still significantly net long NZD and signs of any political risk premium yet to reach extreme levels, we suspect a narrower focus on the 23 September elections could spell further weakness for NZD. A US data-led recovery in US$ sentiment could see NZD/USD temporarily undershoot our 0.71 forecast for 3Q17 – with a break of the 200-DMA (0.7130) supporting this view.
- Even worse, under a “perfect storm” of rising DM yields and greater domestic political uncertainty, we think NZD/USD could drop towards the 0.68-0.69 lows seen in 2017. Our view is that NZD looks vulnerable to greater downside, with US payrolls creating a potential opportunity.
- On the domestic front, we have 2Q manufacturing data (Thu) and the GDT dairy auction (Tue).

		Week ahead bias	Range for week	1 month target
NZD/USD	Spot ref: 0.7160	Mildly Bearish	0.7100-0.7250	0.71

CAD: Big two-way risks going into the BoC meeting

- After a stunning 2Q GDP print of 4.5% QoQ annualised, market chatter of a second successive Bank of Canada (BoC) rate hike at this week's meeting (Wed) has grown. The CAD OIS curve is now pricing in a 55% chance of this happening. We suspect that the BoC may hold back this month and wait till October before hiking; our base case would be fairly CAD negative, with risks of a move back up to 1.2600/50.
- Were the BoC to move this week - which we wouldn't fully rule out given the central bank's proclivity to surprise - the difficulty may be in reigning in optimism about future rate hikes given that we only have the statement this month. Unless we get an explicit signal that the BoC will pause before hiking again, the risks are that a surprise rate hike fuels an unwarranted tightening of financial conditions (including CAD rally) that could choke any nascent recovery. This scenario could see USD/CAD run down to the 1.2250 area.

		Week ahead bias	Range for week	1 month target
USD/CAD	Spot ref: 1.2420	Bullish	1.2300-1.2600	1.30

EUR crosses: Not expecting an eager Riksbank this week

Currency-sensitive Riksbank unlikely to front-run the ECB and this suggests limited scope for EUR/SEK to break 9.45

CHF: Macro data to confirm super dovish SNB bias

- EUR/CHF is consolidating (in bullish fashion) and data released this week should support the SNB's dovish stance. Tuesday sees both GDP & CPI. On the former, slightly better growth in Q2 will still only see YoY levels at 1% (half of the Eurozone), while CPI should remain super low at 0.4% YoY.
- We also wonder whether the SNB intervened in USD/CHF this week at 0.9430 - any sizable jump in CHF sight deposits on Monday might support that view. Overall, we think the ECB will struggle to drive the EUR lower, thus see upside risks to EUR/CHF later in the week after the ECB meeting.

		Week ahead bias	Range for week	1 month target
EUR/CHF	Spot ref: 1.1420	Mildly Bullish	1.1350-1.1480	1.16

SEK: Expecting the Riksbank we know...

- We don't expect the Riksbank meeting (Thu) to point to an earlier start of the tightening cycle - currently pencilled in for 3Q18 in the bank's own forecast - given its historically cautious stance and concerns about the SEK strength weighing on inflation. We note that the trade-weighted SEK is around 2.5% stronger versus the Riksbank forecast.
- Cautious but slightly neutral Riksbank suggests that EUR/SEK should not persistently break the 9.4500 level.

		Week ahead bias	Range for week	1 month target
EUR/SEK	Spot ref: 9.4910	Neutral	9.4390-9.5630	1.16

NOK: Running out of catalysts for further strength

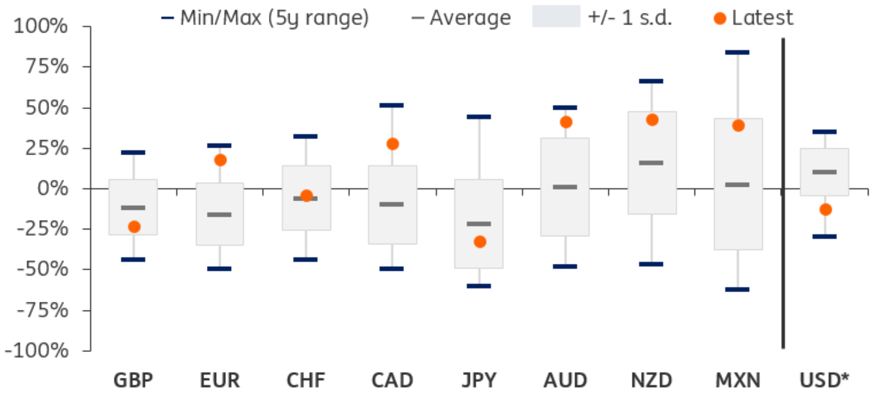
- Bar July Industrial production (Thu), it is a fairly quiet week on the Norwegian data front. With the domestic data upside surprises being the key driver behind the NOK strength over the past few days - and the reason behind the persistent break below the EUR/NOK 9.30 level - this suggests a limited upside to NOK.
- The September ECB meeting should have a limited impact on Scandies, as opposed to the EUR/USD cross for example, thus pointing to a range-bound EUR/NOK.

		Week ahead bias	Range for week	1 month target
EUR/NOK	Spot ref: 9.2760	Neutral	9.2040-9.3400	9.30

G10 FX Positioning: NZD & CAD longs vulnerable

- Net short USD positions remain close to historic lows - and below the 1 standard deviation band - meaning that markets remain significantly bearish on the greenback. Yet, the lack of data or external catalysts to initiate a normalisation in positions means this negative USD sentiment may continue in the near-term.
- NZD longs were trimmed as a narrower focus on domestic politics (23 September elections) and the threat of RBNZ intervention may have initiated some profit-taking. We expect the positioning adjustment to continue, which points to further NZD downside.
- Speculative markets remain significantly long CAD going into the BoC meeting on Wednesday and with investors 50:50 over a rate hike this week, we think an on-hold Poloz could be the catalyst for some of the recent bullish CAD sentiment to unwind.

Speculative positioning (% of open interest)



Source: Source: CFTC, Bloomberg, ING as of 29 Aug 2017 (data reported with a lag)

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