Currency markets getting political... again

Another week, a fresh wave of politics driving currency markets, with the EUR seemingly on the backfoot, at least for now.

Theme of the week: Politics posing questions to EUR bulls

Political events in Germany and Spain over the past few weeks have provided a reality check on the way investors view eurozone political risks. Since the French elections, we've noted that the euro may have been playing the role of a 'political haven' – especially when taking stock of the political risks plaguing the likes of other G4 currencies (namely USD and GBP). However, the return of the 'populist voter' sentiment is a reminder that political risks haven't completely abated for the euro – especially with the spectre of the possibly more contentious Italian elections looming in early 2018. This may be more of a concern for medium-term real money investors (eg, reserve managers), though any fading EZ recovery sentiment could also see a pause in the cyclical EUR upswing.

We note that the ECB policy normalisation story provides a backstop to the EUR. Unlike prior occasions when European political risks have flared, we now have the tailwind of an ECB looking to tighten – or normalise – monetary policy. This should keep EUR/USD supported around 1.17 - although a break of this could see a deeper technical correction towards 1.15-1.16.

Majors: Getting political... again!

Political woes in Europe have provided a reality check on the EUR rally, with the USD finding broad support amid a possible December Fed rate hike and the Republican Party's tax plan noise. Politics also remain in the spotlight for GBP and JPY.

EUR: A second Eurozone political risk reality check

- Big week for US data, which culminates in the release of the Sep jobs report (Fri); our economists are looking for an above-consensus +110k payrolls print - with the fallout from hurricanes Harvey and Irma having a more muted impact. On the wage growth front, we're expecting +0.3% MoM and 2.6% YoY - although this may be in the dollar's price (odds of a Dec hike around 60-70%). It is a move higher in trend wage growth - and signs of 3.0% YoY growth - that matters for the duration of the Fed tightening cycle and would prompt a re-pricing in inflation markets. Among Fed speakers, watch for board member Jerome Powell (Tue & Thu); he's the most likely internal candidate to replace Chair Yellen, though US media also reporting that Trump has met with the likes of former Fed official Kevin Warsh about the job.
- From the EUR side, the focus will be on any jawboning references in the ECB minutes (Thu). The EUR is dropping in response to the outcome of the Catalonian independence referendum that was deemed illegal by the Spanish government. As was the case after the German elections last weekend, we expect the EUR to initially trade on the soft side, yet for now, don't expect a prolonged and long-lasting decline.

		Week ahead bias	Range next week	1 month target
EUR/USD	Spot ref: 1.1750	Neutral	1.1700-1.1950	1.20

Source: Source: ING

JPY: Snap election, strong Tankan, little inflation

- PM Abe announced he would dissolve the diet later this month and call a snap election – most likely on Oct 22 (with campaigning starting on Oct 10). Abe also unveiled plans for a 2 trillion yen economic stimulus package, which would be used mainly for increased spending on child care and education. But the creation of a new "Party of Hope" by Tokyo Gov Koike has got some in markets drawing potential parallels to this snap election and what we saw in the UK in May (with PM May's election misstep). Such sentiment could keep JPY on the back foot.
- Japan's strong 3Q Tankan report, with big gains for large manufacturers (+22 from +18) and gains in most of the other indices, including profits, suggest a number of things: (1) that the momentum behind Japan's economy is still strong; (2) that the Japanese economy can withstand a stronger JPY; and (3) that PM Abe, if he wins the snap election, will find it harder to weasel out of following through on his consumption tax hike pledge this time. Our economists note that it looks to be another strong growth quarter, without much inflation pressure. We also get wage growth data (Fri), which is likely to remain flat-ish and would corroborate this view.

		Week ahead bias	Range next week	1 month target
USD/JPY	Spot ref: 112.90	Mildly Bullish	111.50-113.40	109

Source: Source: ING

GBP: Governing Conservative Party Conference noise mutes BoE story

- The fourth round of Brexit negotiations failed to show signs of any meaningful progress towards a transition deal being signed, sealed and delivered. Although the near-term focus shifts to the Tory Party Conference (which began this weekend), we continue to see a Brexit transition deal as the next big directional catalyst for GBP markets - at least from a cyclical perspective (albeit acknowledging that structural headwinds wouldn't be resolved).
- UK PMI data (Mon-Wed) will be closely monitored for confirmation that the BoE will hike in Nov; we expect the releases to point to a reasonably healthy picture of the domestic economy - though it's worth noting that the surveys are becoming more detached from the official growth numbers. BoE still on track to hike this year if the economy is showing signs of turning the corner after a disappointing summer.

		Week ahead bias	Range next week	1 month target
GBP/USD	Spot ref: 1.3340	Neutral	1.3260-1.3520	1.33

Source: Source: ING

Dollar bloc FX: Consolidation amid a recovering USD

US data will dominate price action for high-yielders this week, though we'll be watching for subtle hawkish hints in the latest RBA policy statement. AUD looks a good relative value play against a politically-hindered NZD and overzealous CAD.

AUD: Still too early for RBA to rock the boat

- RBA meeting this week will take centre stage (Tue); our economists are not looking for any change to the neutral policy bias, with concerns over fuelling AUD strength one of the major reasons for not tilting towards a more hawkish stance. Certainly, the macro backdrop remains mixed: diminishing signs of slack in the labour market and stronger economic activity are positive developments, while inflation remains uncomfortably low. The negative references to a strong currency weighing on growth and inflation are likely to be retained.
- The data focus will be later in the week, with trade and retail sales due (both Friday). Markets looking for consumer spending in Australia to have picked up over Sep (+0.3% MoM).

		Week ahead bias	Range next week	1 month target
AUD/USD	Spot ref: 0.7810	Neutral	0.7760-0.7950	0.78

Source: Source: ING

NZD: Politics weighing but 200-dma to offer support

- The post-election political uncertainty continues - with New Zealand no closer to forming a working government. NZ First's Winston Peters is still refusing to make a decision on which party he would like to form a coalition with (National or Labour) until the full votes have been counted on 7 Oct. This will continue to serve as a near-term headwind, though the NZD/USD fallout has been contained to the 0.71-0.72 area. This suggests markets are still hoping for a National-NZ First coalition.
- After an event-filled week, the domestic calendar is very light. House price data will be of some interest, while we also have the latest bi-weekly GDT dairy auction (both Tue). On the latter, we note that Fonterra kept their forecast payout unchanged - citing that rising prices have been offset by a decline in volumes. Strong fundamentals (terms of trade) should act as a buffer to the kiwi amid the prevailing uncertain political backdrop. We look for the 0.7150 (200-dma) to provide support.

		Week ahead bias	Range next week	1 month target
NZD/USD	Spot ref: 0.7190	Mildly Bullish	0.7150-0.7280	0.71

Source: Source: ING

CAD: Gravitational pull towards 1.27 OECD PPP level

- The combination of a conservative Poloz and flat GDP growth in July has seen a dovish BoC reality check in CAD markets. We think the story still has legs to run - with markets continuing to price in a 55-60% chance of a Dec hike. The rhetoric from Governor Poloz this week suggests that there is no pre-set path for BoC policy - which puts the pace and extent of future tightening under greater scrutiny.
- The second-round effects of a strong CAD and sharp appreciation in financial conditions may come back to haunt the BoC and keep them at bay. We suspect there is at least 25bps worth of downside to the 2-year market-implied policy rate of 1.75% (current 1.00%). With BoC policy highly data-dependent, the focus this week will be on PMI data (Mon & Fri), trade (Thu) and most importantly the Sep jobs report (Fri). Risks are skewed towards data-led CAD downside and we continue to view the OECD PPP fair value of 1.27 as a medium-term anchor point for USD/CAD.

		Week ahead bias	Range next week	1 month target
USD/CAD	Spot ref: 1.2510	Mildly Bullish	1.2350-1.2700	1.24

Source: Source: ING

EUR crosses: Consolidation time

A softer EUR is waning on sentiment for high-beta European currencies. We expect this story to fade, with SEK and NOK to stabilise amid a quiet week in the respective local calendars.

CHF: Eurozone political woes brings 1.14 into focus

- EUR/CHF has been slowly recovering from last Monday's sell-off and we favour support holding around 1.1400 for the week ahead. The main event-driven threat to the EUR this week may come from Thursday's release of ECB minutes and concern over any EUR strength. However, EUR downside should be limited.
- Local events see PMI manufacturing on Monday, seen at cycle highs, and then the CPI release on Thursday. A modest pick-up is expected to 0.6% YoY, but nothing to change the view that the SNB will sit tight with policy settings far longer than the ECB and that EUR/CHF will rally.

		Week ahead bias	Range next week	1 month target
EUR/CHF	Spot ref: 1.1410	Mildly Bullish	1.1400-1.1500	1.17

Source: Source: ING

SEK: Too much unjustified SEK weakness

- We look for EUR/SEK to move back below the 9.6000 level this week as some of the last week's sell-off should prove temporary. We don't see the extension of the current Governor Ingves' term as a game-changer for SEK as we always expected the Riksbank to closely watch the ECB policy moves and remain focused on the currency.
- Potential solid Sweden Sep PMI Manufacturing (Mon) should be supportive for SEK. Also, watch Aug Industrial Production.

		Week ahead bias	Range next week	1 month target
EUR/SEK	Spot ref: 9.6010	Mildly Bearish	9.5470-9.6610	9.50

Source: Source: ING

NOK: Stabilisation after the sell off

- We expect EUR/NOK to stabilise following last week's sell-off. On the data front, the Sep Manufacturing PMI should be NOK supportive following the downside surprise to the Aug retail sales on Friday.
- We also believe that some of last week's NOK weakness was caused by long Scandies / short USD positions reaching stop loss levels following the move in EUR/USD lower. With EUR/USD stabilising, this channel should have a limited impact on NOK.

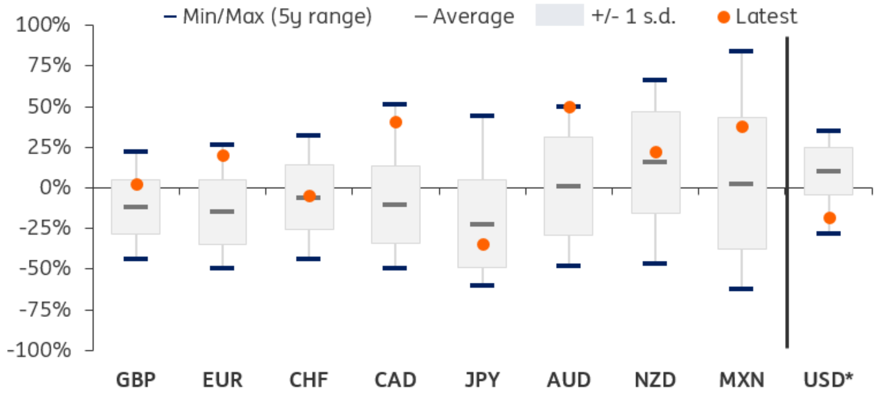
		Week ahead bias	Range next week	1 month target
EUR/NOK	Spot ref: 9.3930	Mildly Bearish	9.3260-9.4620	9.30

Source: Source: ING

G10 FX Positioning: GBP turns net long

- GBP positioning turned net long for the first time since October 2015 as the BoE talks up 2017 rate hike prospects, while short-term political risks diminish
- JPY shorts picked up on the week and registered a bearish signal on our monthly sentiment indicator. But with net USD positions turning more negative, we believe any positive US story is only really being played out in USD/JPY
- Spec markets still remain bullish on CAD, though a more conservative Poloz and soft Canadian data is likely to test this sentiment

Speculative positioning (% of open interest)



Source: Source: ING estimates, Bloomberg, CFTC data as of 26 Sep 2017

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