G10 FX Week Ahead: Watching Bonds

The prime driver of the G10 FX cross this week will be the general risk appetite, rather than specific domestic idiosyncratic drivers. With the bond market sell-off (10y UST being shy of the 2.90% level) spilling into risky assets, the effect of this global factor will be key

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Navigating the bond market sell off

If the current trend of rising core yields continues, we expect the commodity G10 FX segment to underperformer G10 FX low yielders. Among the majors, JPY seems to be in the best place, whereby the positive spillover from the risk-off environment (the effect) outweighs the normally negative implications from higher core yields (the cause) on the yen. In the emerging market FX space, highly liquid risk-sensitive currencies such as Korean won or high yielders with external funding needs (Turkish lira, South African rand) are vulnerable. In contrast, we look for a limited spillover into the low beta Central and Eastern European FX, which also remains shielded by the stable EUR/USD.

The EUR/USD remains resilient to both the positive US data surprises (as per the limited downside to the cross after the strong Jan US labour marker report) and the global negative risk sentiment. This very clearly underlines the very high bar for an EUR/USD downside.

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2470	Neutral	1.2330 - 1.2540	1.2500

- In a relatively calm week on the US and Eurozone data front, we look for consolidation in the EUR/USD.
- Despite a very strong US labour market report (namely wage growth), the experience so far this year suggests that the positive spillover into the USD will be limited. Equally, we don't think that any attempt to talk down the Euro from ECB board members will bear any fruit at this point.

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.80	Mildly bearish	108.28 - 111.20	109.00

- The Japanese yen seems to be in a sweet spot, whereby the positive spillover from the risk-off environment (the effect) outweighs the normally negative implications from higher core yields (the cause) on the yen. As long as the current trend of rising yields / falling stock market continues, JPY should be the G10 FX outperformer.
- Japanese domestic data (such as the Dec Trade balance on Wed) remains a non-driver of the cross. We see a growing risk of this year's low of USD/JPY 108.28 being re-tested.

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.4110	Neutral	1.4050 - 1.4350	1.4300

- The highlight this week is Thursday's Bank of England rate meeting. We think there is a chance the BoE upgrades its growth target, which may firm up expectations of a 25bp hike in May. Currently the market is split on a May rate hike. As usual, there will also be a focus on the inflation report and whether the BoE sees CPI on its 2% target in two years time.
- Local data contributing to the GBP story this week will be services PMI (Mon) and Industrial production and trade (Fri). So far, pressure on Prime Minister Theresa May has yet to translate into a GBP weakness.

	Spot	Week ahead bias	Range next week	1 month target
USD/CHF	0.9300	Neutral	0.9250 - 0.9420	0.9200

- The powerful USD/CHF downtrend received a reprieve from the strong US jobs data. After recent major downside break-outs, shallow corrections look most likely, suggesting fresh selling for USD/CHF may emerge in the 0.9400/9450 area. There is no Swiss data of note this week.
- We suspect that EUR/CHF might have been intervening in the 1.1550/1580 area. Last year, the Swiss National Bank seemed to make a case of making sure EUR/CHF corrections were shallow and we are not in the camp thinking they are normalising policy. The USD/CHF decline actually makes CHF trade-weighted stronger - keeping the SNB wary of broad-based CHF strength. Any progress on the German coalition government could also give EUR/CHF a lift.

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7940	Mildly bearish	0.7920 - 0.8020	0.7800

- The highlight of the week will be the first RBA meeting of the year on Tuesday. Currrently, the market does not price the first hike until November, with the RBA giving no sign it is in a hurry to adjust monetary policy settings. However, the RBA as always is sensitive to currency strength and with AUD/USD not far from 0.80, will be wary of changing its stance - e.g. incorporating a more bullish/global commodity outlook.
- AUD has been under-performing in recent sessions and higher US yields (where the strong US story should be played out) look set to keep the pressure on AUD/USD for the time being. AUD/NZD has key support in the 1.0825/45 area.

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7310	Mildly bearish	0.7250 - 0.7375	0.7200

- Strong US jobs data knocked the high yielders, leaving the commodity currencies trapped between the growth and the US rates story. We think US yields could play a slightly larger role on the US high yielders - especially were a theme to develop of the Fed being behind the curve. A slightly harsher external environment could, therefore, see NZD come off a little more.
- Locally, all the focus will be on the RBNZ's OCR decision on Wednesday. The market is set on its view that rates will not be adjusted for the remainder of 2018 (barely one hike is priced). Though views on that trajectory could be impacted by the 4Q employment data which comes out on Tues.

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2420	Neutral	1.2280 - 1.2450	1.2400

- The Canadian dollar and Mexican peso are performing reasonably well, with no knock-out blow yet to be delivered by NAFTA - next talks on Feb 26th in Mexico. Despite the rise in US yields, CAD yields are just about keeping pace (10-year spread still 40-50bp), which may be lending CAD a little support. Market is currently fully pricing in a May BoC hike to 1.50% and will also be focusing on any insights on a) growing capacity constraints & b) inflation in helping the BoC to make the decision.
- In terms of the week ahead, the local highlight will be trade data on Tuesday, a speech from BoC's Wilkins on Thurs and the January payrolls data on Friday. The market expects a softer jobs report after the stellar December figures. Should jobs surprise on the upside, as the US data has, CAD could out-perform.

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	9.8270	Neutral	9.7340 - 9.8720	9.7000

- We look for yet another week of range trading in EUR/SEK around 9.80. Following the downside surprise to the Manufacturing PMI last week (thought the reading was strong), this week's data (namely Dec IP on Tue and Jan average house prices on Fri) should not be a catalyst for a material decline in EUR/SEK.
- While EUR/SEK is largely flat since the begging of the year, the trade weighed SEK (the KIX index) is, in fact, stronger given the dollar's weakness. With the KIX now being largely in line with the Riksbank forecast, the central bank has no impetus to induce stronger / weaker currency.

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.6080	Mildly bearish	9.4920 - 9.6810	9.6000

- Norwegian 4Q GDP and January inflation figures (Fri) should both be solid in turn (a) further support Norge's Bank's shift towards a December hike (b) keep the positive sentiment towards NOK in place
- The domestic data should help to (at least partly) offset the negative effect form the external environment, whereby the rising core yields weigh on risk appetite and the oil price – both being clearly NOK negative. That EUR/USD remains resilient and the krone being still materially undervalued should also partly shield NOK from a risk a of a more pronounced sell-off

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