

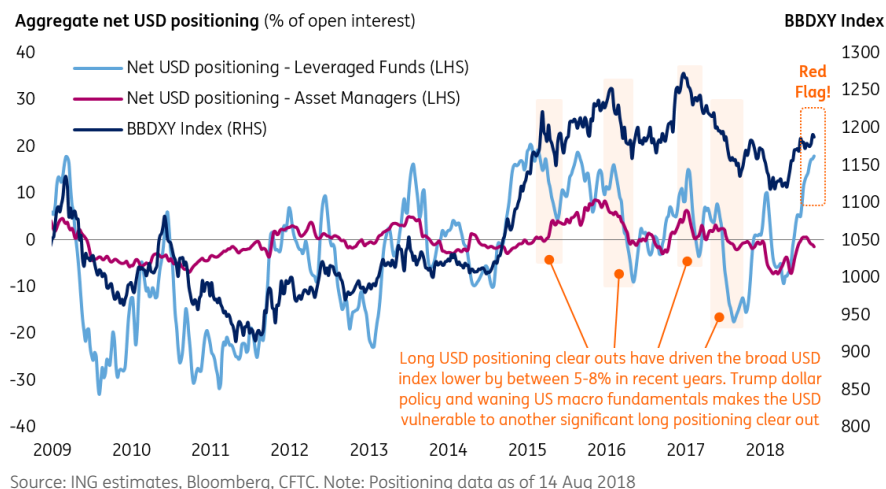
## G10 FX Week Ahead: Fed Dancing With The Stars

With Federal Reserve Chair Jerome Powell dancing with the economic stars and focusing on the big picture in his Jackson Hole speech, risky assets can breathe a temporary sigh of relief as US interest rates are unlikely to escape meaningfully higher. But with FX markets being driven by politics, pitching an economic story makes little sense to us right now



The Fed's Jerome Powell and the IMF's Christine Lagarde in Buenos Aires, July 2018

## A dollar running out of fresh impetus looks vulnerable to a long positioning adjustment



### EUR: Reserved Powell at Jackson Hole gives dollar bulls little support

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1630	Mildly Bullish <span style="color: green;">↗</span>	1.1500 - 1.1720	1.1500

- For global markets, the key line from Fed Chair Powell's Jackson Hole speech was "*we have seen no clear sign of an acceleration above 2 percent, and there does not seem to be an elevated risk of overheating*". This provided some modest support for global risk sentiment – not least as investors can take some comfort in the fact that the Federal Reserve is unlikely to accelerate their current policy tightening plans. The lack of fresh Fed impetus comes at a time when the dollar is running out of positive catalysts – domestic political uncertainties (Trump and Cohen), Trump jawboning (see our note [Dethroning the King](#)), fading positive US data surprises, extreme long USD positioning (see chart above) means that we think the broad dollar index has most likely put in a short-term cyclical top now. We'll be closely watching US leading indicators (Chicago PMI and Dallas Fed indices) in the coming week; the theme for regional US activity indices so far has been a decline in new orders as trade uncertainties weigh. Other data points to note are US consumer confidence (Tue), the second release of 2Q US GDP (Wed), core PCE inflation (Thu) and University of Michigan Sentiment index.
- Investors this week will be looking to leading Eurozone economic indicators to gauge the ECB's mood at the mid-September policy meeting; in Germany, our economists expect the Aug IFO data (Mon) to nudge slightly higher, while the flash August EZ CPI data (Fri) will also be closely watched to see if inflation remains sticky above 2%. Political risks remain a short-term limiting factor for the EUR – with both Turkey and Italy still bubbling in the backdrop. On the former, Turkey's markets return from holiday – while on the latter, there's a Fitch review on Italian sovereign debt at the end of the week. These lingering political uncertainties suggest that EUR/USD rallies are likely to be faded fairly quickly.

## JPY: Buoyed by the Teflon Don

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	111.30	Neutral	110.50 - 111.80	110.00

- USD/JPY has been buoyed by Donald Trump's ability to avoid being severely damaged by the news agenda and the continued rise of US equities. Fed Chair Powell's comments at Jackson Hole should also contribute to further US yield curve flattening with further gradual Fed hikes expected later this year. As we've noted before we think a flatter US yield curve is a positive for USD/JPY as Japanese investors find it too expensive to FX hedge purchases of US Treasuries. It may not be until the market were ever to question the need for two further Fed rate hikes this year that USD/JPY would start to correct lower.
- In Japan, we'll see data on consumer confidence, retail sales and Industrial Production this week. The latest run of CPI data showed inflation still running at 0.9/1.0% YoY and not really providing any urgency about the need for BoJ to exit super-loose policy. What could come into focus over coming weeks, however, is the LDP leadership election. Were fears to build that Abe could be ousted, we'd see that as a JPY positive on the view that super-reflationary Abenomics policies could be curtailed.

## GBP: The 'BLT' problem - Brexit Looming Trouble

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2850	Neutral	1.2800 - 1.2950	1.2700

- It's clear that a lot of bad news is priced into a pound plagued by twin sources of risk premia. But when it comes to Brexit and the currency, talks between the UK and the EU are not necessarily the primary short-term risk. In fact, some investors may have found comfort from the Raab-Barnier press conference over the past week – especially as it was clear that the EU isn't actively looking to push the UK off any Brexit cliff edge (which makes sense given that a no-deal Brexit would be somewhat damaging to both economies). The inherent willingness of both sides to find a Withdrawal Deal solution should serve as a bit of a backstop to the degree of no-deal Brexit risks priced into the currency.
- But when it comes to GBP and political risks, it is far too early to signal the all clear; the biggest test for the pound will be the return of a divided UK parliament from their summer recess and the upcoming Party Conference Season. A murky UK political backdrop may continue to put a dampener on GBP in the near-term – but as we noted last week, risk-reward may no longer favour chasing the pound much lower from these levels. We think GBP/USD at 1.27 (and EUR/GBP at 0.91) reflects a good chunk of Brexit negativity – and look for a stable, yet volatile, GBP. The week ahead sees UK money supply data (Thu) and consumer confidence (Fri).

## AUD: Week of political upheaval ends with a new Prime Minister

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7300	Neutral	0.7250 - 0.7380	0.7200

- The near-inevitable resignation of Australia's Prime Minister, Malcolm Turnbull, on Friday resulted in a leadership contest that saw Treasurer Scott Morrison narrowly pip Home Affairs Minister Peter Dutton to become Australia's sixth leader in just over a decade. While the AUD saw a knee-jerk move higher on Morrison's appointment, the fragile political backdrop still remains a cause of concern. The week ahead sees the closely watched 2Q Private Capex data (Thu) v with markets expecting a minor uptick to 0.6% (versus 0.4% prior). This may provide a bit of temporary support to the AUD.
- But as [ING's Rob Carnell astutely notes](#), there are other reasons to expect some medium-term weakness in the AUD though – namely because we aren't convinced that the economy is in as good shape as the popular view on Australia runs. An absence of RBA policy changes over recent years has allowed household debt to balloon. Meanwhile, the property market across almost the entire country is beginning to cool, and we doubt an about-face in lending standards by APRA will be sufficient, or fast enough to turn it around. Based on this, we're inclined to say that AUD/USD will see greater risks of running down to 0.70 (rather than recovering above 0.75) – although this will also depend on the broader global economic outlook and USD profile.

## NZD: RBNZ in no rush to hike interest rates

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6660	Neutral	0.6600 - 0.6720	0.6600

- It's been a pretty quiet week for the NZD – which has simply matched the ebbs and flows over the broader global risk environment. RBNZ Governor Orr at Jackson Hole reiterated that the central bank intends to hold policy rates low for an extended period of time (and also didn't rule out a rate cut if needed). This sentiment is likely to keep a lid on short-term New Zealand rates and the Kiwi dollar. The only small positive for the NZD right now is the speculative markets' extreme short positioning.
- New Zealand dairy prices have been slipping in recent months (down more than 12% since the middle of June) – which presents another near-term headwind for the kiwi. This weaker terms-of-trade story may also be seen in the latest trade data – with the country posting its largest trade deficit (\$4.44bn) since March 2009. The week ahead sees Aug business confidence data (Thu) – which is worth keeping an eye on given that the RBNZ has cited weak investment intentions as a reason for a more subdued outlook for the New Zealand economy.

## CAD: Strong upside risks as BoC policy outlook potentially mispriced

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3065	Mildly Bearish 	1.2950 - 1.3140	1.2900

- Narrowing our focus to the September Bank of Canada meeting (5 Sep), we think there are potential upside risks to the CAD – with markets underestimating the odds of a 25bp rate hike at the meeting. While only a 27% chance of a hike is priced into the CAD OIS curve, our economists feel that the recent flurry of positive data – namely the July labor market and inflation reports – justifies Governor Poloz delivering a second successive rate hike in 2018 (after having raised interest rates in July). Moreover, NAFTA uncertainties have not necessarily thwarted the economy – while hopes of a deal in the near-term should give the BoC some confidence over tightening.
- 2Q Canadian GDP data in the week ahead (Wed) may effectively seal the deal; our economists are looking for a 3.0% QoQ annualised print – which is a touch stronger than the BoC's own 2.8% estimate in the July Monetary Policy Report. Governor Poloz may use his speaking opportunity at Jackson Hole to nudge markets towards the possibility of a September hike – although we know that the BoC chief prefers to keep markets guessing over policy decisions and is not afraid to surprise. Look for CAD to retain a bullish tone ahead of the Sep BoC meeting – with risks of a hawkish BoC re-pricing at the front-end of the curve driving CAD sharply higher (USD/CAD to 1.28-1.29). [Canadian politics](#) and the run-in to the May 2019 elections is something to watch out for – although this may not be an active risk until later in the year.

## CHF: Nervous markets will keep franc in demand

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1400	Neutral	1.1330 - 1.1430	1.1300

- Turkey's holiday and some PBOC-managed stability in \$/CNY have helped to stabilise financial markets and settled EUR/CHF. There is not an obvious catalyst for a EUR/CHF move over the coming week, although we'll probably hear more about Italian debt (ahead of the Fitch review on Friday) and perhaps get some fresh inputs from Turkey as well. Local data will see the Swiss KOF survey on Thursday, which has recently stabilised after a sharp decline through the first half of the year.
- We doubt EUR/CHF will make it much higher near-term given a variety of risks, such as: 1) the variety of EM risks exposed by US sanctions and poor policy choices locally and 2) risks of a US equity correction as the Fed continues to tighten and discussions of Trump impeachment grow. We also note that one of the largest speculative long dollar positions out there is held against the CHF, warning that CHF could end up out-performing the EUR in the event of any broad-based position adjustment.

## SEK: Election proximity starting to weigh

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.5900	Bullish ↗	10.5200 - 10.6500	10.6000

- As we noted last week, we think political risk could be starting to play a role in the SEK. Investors have started factoring in the [upcoming general election on 9 September](#). Polls suggest the likely outcome is a hung parliament and record support for the far-right, anti-EU Sweden Democrats. A messy election and potentially lengthy negotiations to form a new government mean political uncertainty and could easily become another negative factor for SEK over the coming months.
- Swedish data in the week ahead will be Retail Sales (Tuesday) and the Economic Tendency Survey (Thursday). The latter has been stabilising not far from cycle highs, but the fear of escalating US sanctions, slowing trade growth and the political risk premium all look set to keep the SEK on the back foot.

## NOK: Struggling to find friends

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.6970	Neutral	9.6500 - 9.7500	9.6000

- NOK still struggles to find support even though it has: i) energy, ii) a hawkish Norges Bank and iii) SEK weakness in its favour. It's not clear what's driving this weakness, but perhaps similar to Russia, its programme of FX buying for a fiscal rule may be pressuring the NOK in thin summer markets.
- In Norway this week, we'll see Consumer Confidence on Tuesday and the unemployment rate on Thursday. Both of these should reflect an economy growing with enough momentum that should allow Norges Bank to hike rates in September.

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