# G10 FX: Dollar decline looks too good to be true

FX markets are assuming that central banks can signal the all-clear on inflation and deliver gentle easing cycles to ensure soft landings in 2023. We suspect the reality will not be quite as kind to financial markets. We back a stronger dollar into early 2023 and favour the defensive Japanese yen and Swiss franc when the dollar does properly turn

Source: Shutterstock

### Main ING G10 FX forecasts

| | EUR/USD | | USD/JPY | | GBP/USD | |
|---|---|---|---|---|---|---|
| 1M | 1.02 | ↓ | 138.00 | ↑ | 1.17 | ↓ |
| 3M | 0.98 | ↓ | 140.00 | ↑ | 1.10 | ↓ |
| 6M | 1.00 | ↓ | 138.00 | ↑ | 1.14 | ↓ |
| 12M | 1.00 | ↓ | 130.00 | → | 1.14 | ↓ |

| | EUR/GBP | | EUR/CHF | | USD/CAD | |
|---|---|---|---|---|---|---|
| 1M | 0.87 | ↑ | 0.97 | ↓ | 1.38 | ↑ |
| 3M | 0.89 | ↑ | 0.95 | ↓ | 1.35 | ↓ |
| 6M | 0.88 | ↑ | 0.92 | ↓ | 1.33 | ↓ |
| 12M | 0.88 | ↑ | 0.95 | ↓ | 1.26 | ↓ |

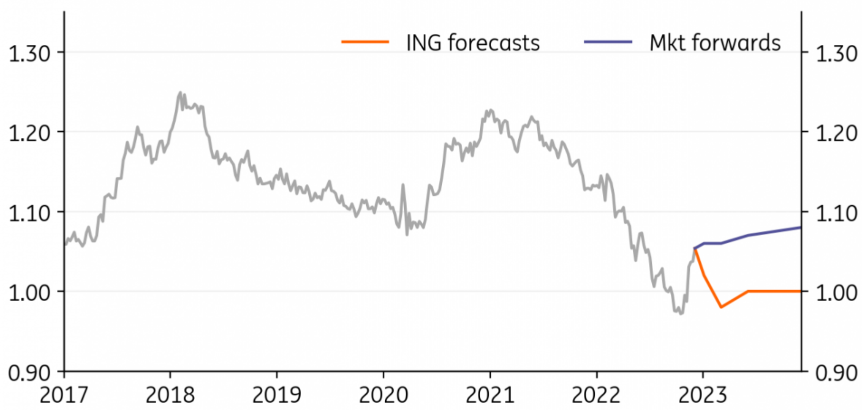
↑ / → / ↓ indicates our forecast for the currency pair is above/in line with/below the corresponding market forward or NDF outright

Source (all charts and tables): Refinitiv, ING forecast

### EUR/USD: Wishful thinking

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/USD | 1.0540 | Bearish | 1.02 | 0.98 | 1.00 | 1.00 |

- The sharp rally in EUR/USD (plus bonds and equities) has all the hallmarks of a short squeeze as markets shift to benign pricing of a turn in the inflation cycle and a soft landing in 2023. At this stage we think this is more wishful thinking and the draw of 4.50-5.00% USD deposit rates will keep the dollar stronger for longer.
- Currently we see the Fed taking rates to 5.00%, the ECB taking rates to 2.25% and then shifting to a pause. Fed rate cuts in 2H23 may not be enough to weaken the dollar if Europe and China are still struggling to grow.
- Consensus sees EUR/USD near 1.10 at the end of 2023. We suspect it closes 2023 nearer parity given recession and energy concerns.

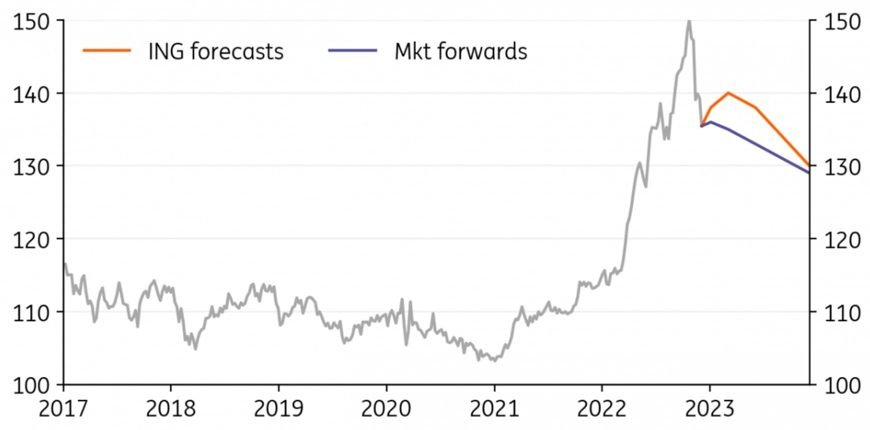



Source: Refinitiv, ING

## USD/JPY: At the forefront of the bond market battle

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| USD/JPY | 137.70 | Neutral | 138.00 | 140.00 | 138.00 | 130.00 |

- One of the hottest financial market topics is how the massively inverted US yield curve resolves itself. The recent bullish inversion (longer-dated yields falling heavily) has dragged USD/JPY sharply lower. US$70bn of FX intervention in September and October has helped too.
- Our near-term call on the yield curve would be a bearish disinversion, where US 10-year yields head back to 4.00% into 1Q23 – likely dragging USD/JPY back above 140.
- We doubt USD/JPY sustains gains over 142.50/145.00 and as the end of 1Q23 approaches and we focus on the next Bank of Japan governor (someone less dovish?), USD/JPY should be pressured again. USD/JPY could be trading well under 130 by the end of 2023.

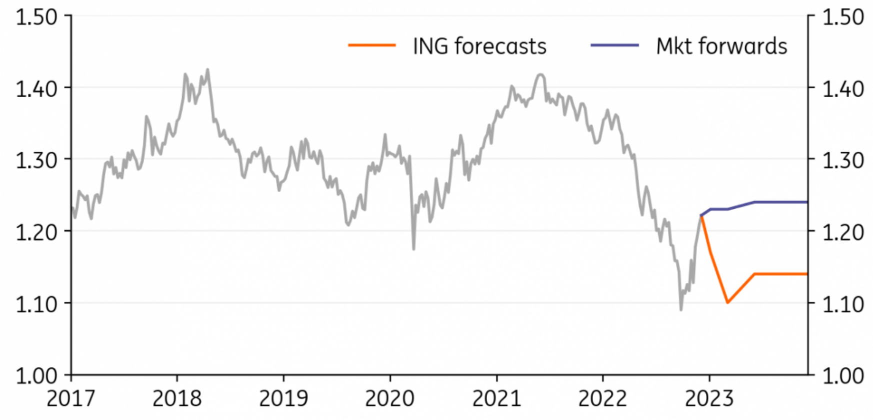



Source: Refinitiv, ING

## GBP/USD: Unstable recovery

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| GBP/USD | 1.2270 | Bearish | 1.17 | 1.10 | 1.14 | 1.14 |

- Sterling trade-weighted has bounced around 8% from September's low. Half of that probably owes to the new UK government undoing the fiscal excesses of former Prime Minister Liz Truss and the other half down to the broad sell-off. We tend to think sterling has rallied far enough on both of those stories.
- We see 1.23 as a pivotal area for Cable into year-end. Closes above there suggest Cable could push onto the 1.28 even 1.30 area – a move fundamentals would struggle to support.
- Tight fiscal and monetary policy heading into a recession stand to make UK asset markets unattractive. And GBP should fall when the Bank of England calls time on its tightening cycle.

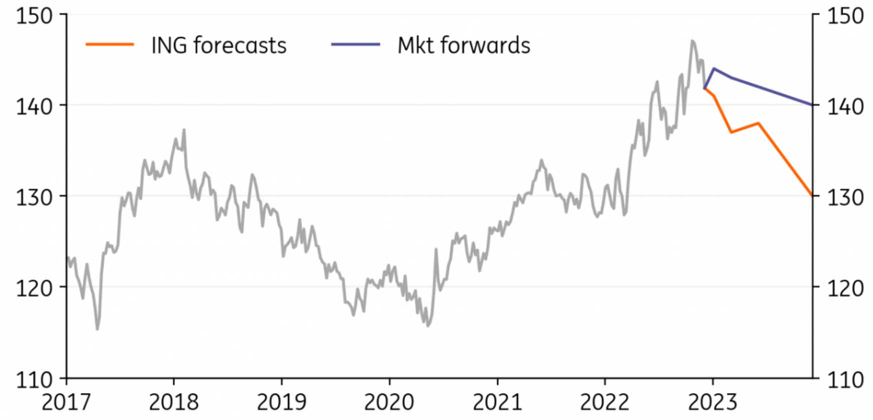



Source: Refinitiv, ING

## EUR/JPY: Here's why the JPY outperforms

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/JPY | 145.1000 | Mildly Bearish | 141.00 | 137.00 | 138.00 | 130.00 |

- It looks like EUR/JPY put in a major high near 148 in October and we think the risks are skewed towards the 130 area through 2023. Driving that call is the Japanese yen reverting to a defensive currency amid the global slowdown. And our eurozone team are very happy to be sub consensus on eurozone growth as the German business model undergoes an overhaul.
- Add in the speculation over the change in Bank of Japan governor in early April (surely no one can be as dovish as current governor Haruhiko Kuroda) and the yen should out-perform.
- We also expect USD/JPY to drop the most on the longer-term bond rally, where US 10-year yields end 2023 near 2.75/3.00%.

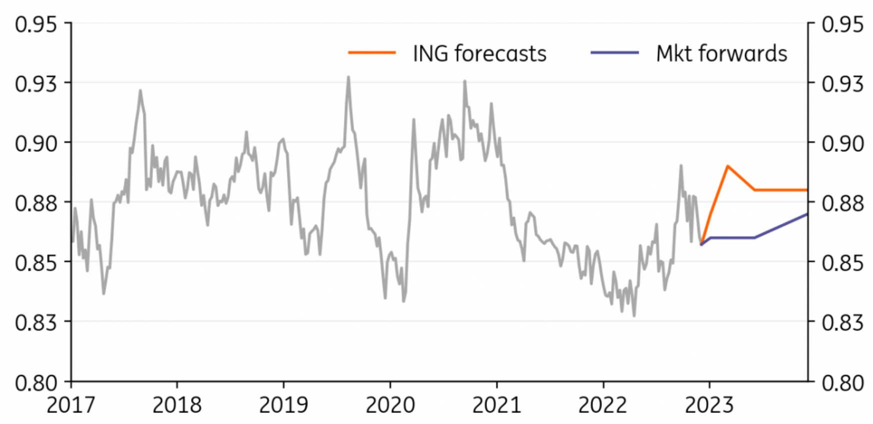



Source: Refinitiv, ING

## EUR/GBP: Bias for sterling under-performance

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/GBP | 0.8590 | Mildly Bullish | 0.87 | 0.89 | 0.88 | 0.88 |

- EUR/GBP continues to correct from the excesses of September and 2023 will be a difficult call. We do not see why EUR/GBP needs to trade a lot lower than 0.8500. True interest rates at the short end of the curve will remain around 125-150bp in sterling's favour for most of the year, but we think the Bank of England will be keener to cut in 2023 given the UK's fiscal tightening.
- Additionally, a poor year for growth – and another difficult one for equity markets – suggests the UK will require a cheaper exchange rate to attract investments. Let's see as well whether the UK's 6% of GDP current account deficit can narrow at all.
- As always, UK politics remains the wild card here.

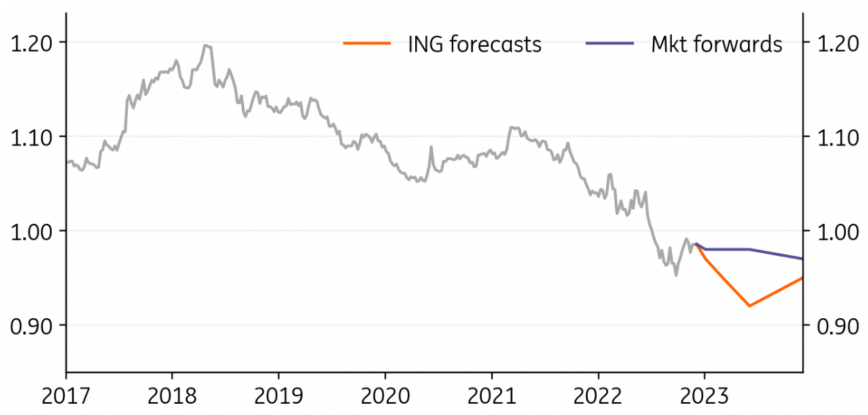



Source: Refinitiv, ING

## EUR/CHF: Nominal Swiss franc appreciation still favoured

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/CHF | 0.9880 | Mildly Bearish ↘ | 0.97 | 0.95 | 0.92 | 0.95 |

- EUR/CHF has drifted to the top of recent ranges – questioning whether the Swiss National Bank (SNB) still wants a strong Swiss franc. Yet USD/CHF is a lot lower and the nominal trade-weighted Swiss franc is still about 4% higher year-to-date. As long as the SNB is still concerned about inflation, it should still want a stronger nominal CHF.
- What form will a stronger CHF take? If we are right with our call for a stronger dollar into 1Q23, then EUR/CHF will have to shoulder more of the adjustment and this is why we can see it down to 0.92/0.95
- Our bearish view on EUR/CHF would come undone should the SNB signal the all-clear on inflation or should the dollar sell off more dramatically – neither of which is our preferred view.

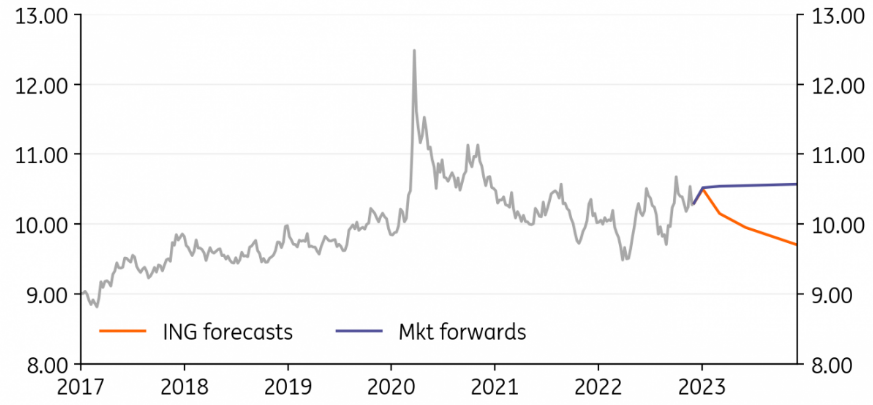



Source: Refinitiv, ING

## EUR/NOK: Looking for direction

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/NOK | 10.5400 | Neutral | 10.50 | 10.15 | 9.95 | 9.70 |

- NOK has been held back by the recent drop in energy prices. The tightening supply picture does bode well for a recovery in oil and gas prices, and we continue to favour a downward-sloping profile for EUR/NOK in 2023.
- However, NOK's low liquidity conditions continue to suggest volatility should remain elevated as global markets face more uncertain times in the months ahead.
- Domestically, Norges Bank should hike by another 50bp in our view. It has underdelivered (compared to consensus) on NOK sales for the past two months, which may signal a shift to a more accommodative stance on a strong NOK to fight inflation.

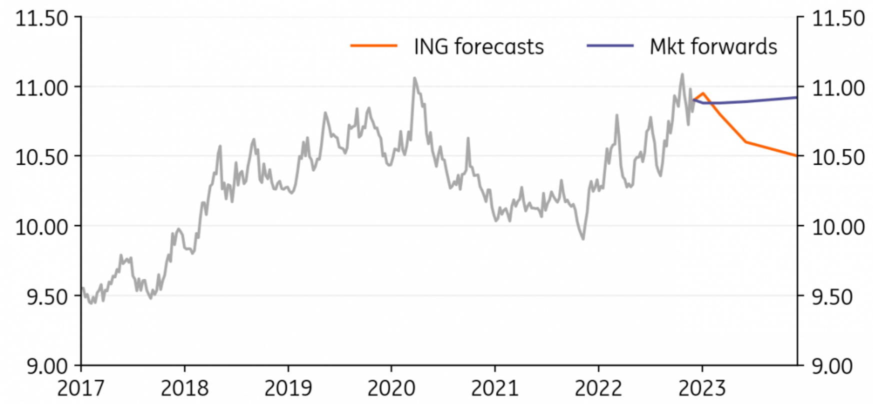



Source: Refinitiv, ING

## EUR/SEK: Krona facing the usual short-term risks

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/SEK | 10.9000 | Neutral | 10.95 | 10.80 | 10.60 | 10.50 |

- The krona has shown resilience against the dollar in the past month but underperformed against the euro. We continue to see downside risks for SEK in the near term, largely due to a potential re-deterioration of global and EU-specific risk sentiment.
- We estimate that Riksbank will hike by another 75bp before ending its tightening cycle, but the next policy meeting is only in February: inflation readings should offer markets some clearer guidance before then. Erik Thedéen will become the new governor on 1 January, but any change in the policy approach may only be gradual.
- EUR/SEK remains at risk of returning to 11.00 in the near term. But we still see a modestly bearish profile for the pair in 2023.

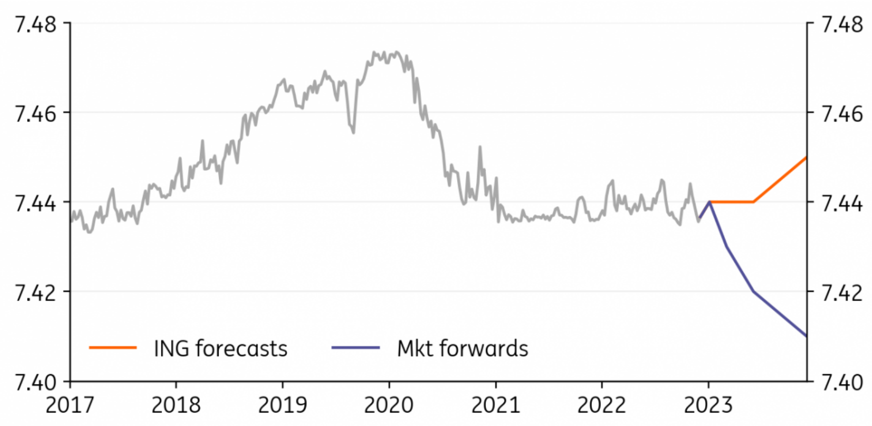



Source: Refinitiv, ING

## EUR/DKK: DN slows FX intervention

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| EUR/DKK | 7.4380 | Neutral | 7.44 | 7.44 | 7.44 | 7.45 |

- Danmarks Nationalbank (DN) intervened in the FX market for a third consecutive month in November, but by a much smaller amount: DKK 3.7bn versus a combined DKK 45bn sold in September and October.
- The large swings in EUR/DKK around the ECB and DN rate hikes in late October and early November are highly undesirable for the DN. EUR/DKK is trading around 7.4380 at the moment, so with a small cushion against the peg's lower bound.
- With the ECB set to hike by 50bp or 75bp in December, there is surely room for smaller increases by the DN to widen the rate gap. However, high inflation in Denmark and the slowdown in FX sales in November argue against excessive dovishness.

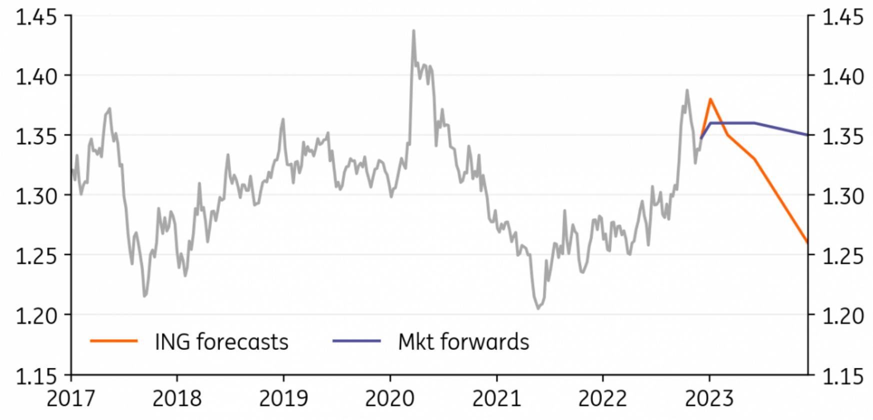



Source: Refinitiv, ING

## USD/CAD: Don't rule out 2023 loonie outperformance

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| USD/CAD | 1.3620 | Mildly Bullish | 1.38 | 1.35 | 1.33 | 1.26 |

- The Bank of Canada is emerging as a dovish outlier in the G10 space, as the latest 50bp rate increase was accompanied by strong hints it may have been the last hike of this cycle.
- Rate differentials aren't however a key determinant of FX moves at the moment, and this may not change until market sentiment stabilises and allows more search for carry. We think external factors will remain a much more important factor for CAD compared to the Bank of Canada policy.
- While a USD rebound and unstable equity markets point to more potential pain in the short term, we expect a recovery in energy prices and low exposure to China and Europe to fuel a sustained USD/CAD downtrend in 2023.

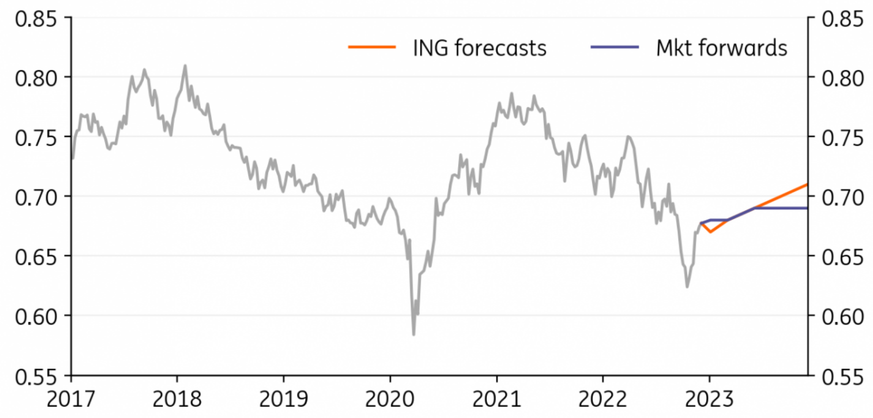



Source: Refinitiv, ING

## AUD/USD: China's sentiment swings in focus

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| AUD/USD | 0.6760 | Neutral | 0.67 | 0.68 | 0.69 | 0.71 |

- The fate of AUD remains strictly tied to the market's sentiment on China. If a potentially faster-than-expected exit from strict Covid-19 rules would surely be positive, the real estate and export sectors should keep clouding China's outlook.
- Despite a very tight jobs market, inflation and growth have slowed and this should allow the Reserve Bank of Australia to retain full flexibility (even a hold) for its first meeting of 2023. Another 25bp hike is, however, our base-case scenario for February.
- We think the recent rally in AUD/USD will keep losing steam and we see the pair trade around 0.68 until the first quarter of 2023.

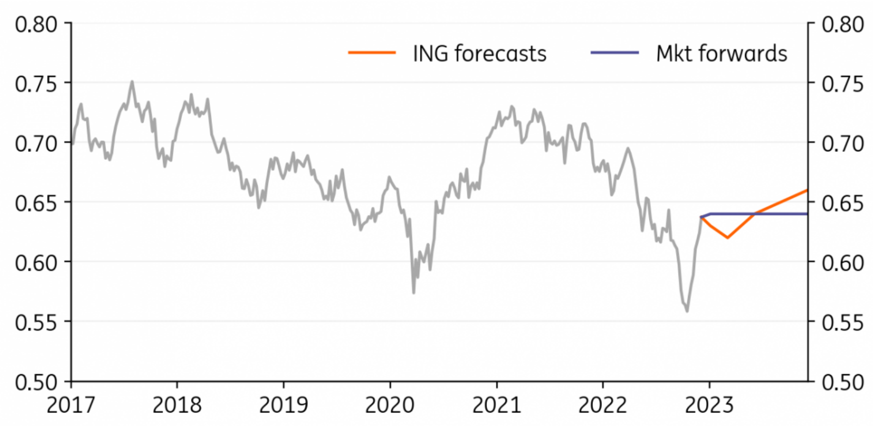



Source: Refinitiv, ING

## NSD/USD: Not trusting another big rally

| | Spot | One month bias | 1M | 3M | 6M | 12M |
|---|---|---|---|---|---|---|
| NZD/USD | 0.6390 | Mildly Bearish | 0.63 | 0.62 | 0.64 | 0.66 |

- The Kiwi dollar has been the best G10 performer in the past month, lifted by China optimism and position-squaring.
- NZD/USD looks vulnerable should market optimism on China prove premature, USD re-appreciates (as we expect) and risk sentiment drops. But the current environment may also allow some consolidation in the near term.
- Domestically, the ultra-hawkish Reserve Bank of New Zealand has also offered NZD some help. However, the ongoing correction in house prices may accelerate beyond the Bank's tolerance levels and we see a high chance of policymakers underdelivering compared to the 5.5% OCR signalled in rate path projections.




Source: Refinitiv, ING

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