G10 FX Talking: The case against the dollar isn't strong enough

FX markets have been quiet this summer. This is because interest rate volatility has dropped off as central banks complete tightening cycles and promise that rates will need to be left near these highs for extended periods. The carry trade should continue to be favoured over the coming months and probably pushes the start of the dollar bear trend into 4Q23

Source: Shutterstock

Main ING G10 FX forecasts

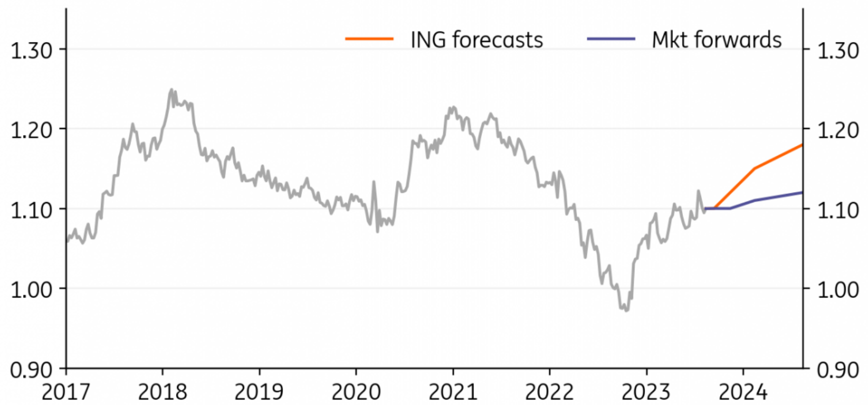
	EUR/USD	USD/JPY	GBP/USD
1M	1.10 ↑	140 ↓	1.28 →
3M	1.12 ↑	135 ↓	1.29 ↑
6M	1.15 ↑	130 ↓	1.31 ↑
12M	1.18 ↑	120 ↓	1.34 ↑

	EUR/GBP	EUR/CHF	USD/CAD
1M	0.86 →	0.97 ↑	1.32 ↓
3M	0.87 →	0.96 →	1.29 ↓
6M	0.88 ↑	0.97 ↑	1.27 ↓
12M	0.88 →	1.00 ↑	1.25 ↓

EUR/USD: Dollar resilience continues

	Spot	One month bias	1M	3M	6M	12M
EUR/USD	1.0998	Neutral	1.10	1.12	1.15	1.18

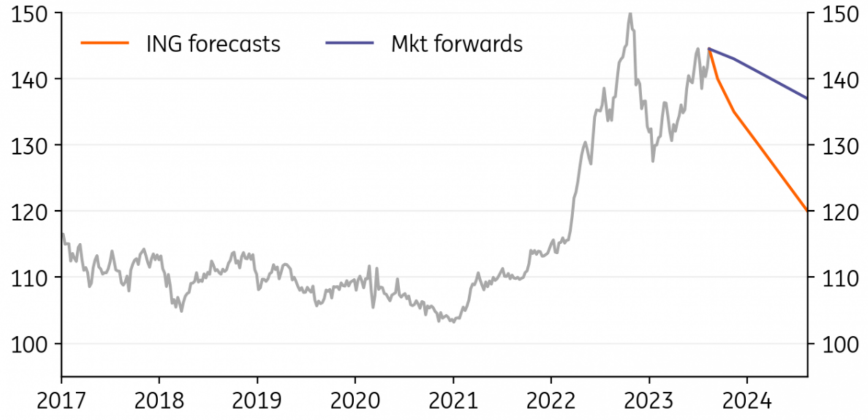
- Last month we thought the softer US CPI could be the trigger for a cyclical dollar decline – but that has not been the case. Two factors are probably driving this dollar resilience. The first is that US activity (particularly the labour market and consumption) are holding up well, even as growth prospects in China and the eurozone appear to deteriorate.
- The second is the prospect of the Fed staying on hold for an extended period. Low US rate volatility favours the carry trade. With 5%+ overnight rates, the dollar looks neutral here.
- Our house call is, however, that US disinflation continues, activity slows and the Fed cuts in 1Q24. $ decline should take hold 4Q23.



USD/JPY: Carry trade keeps yen under pressure

	Spot	One month bias	1M	3M	6M	12M
USD/JPY	144.50	Mildly Bearish	140.00	135.00	130.00	120.00

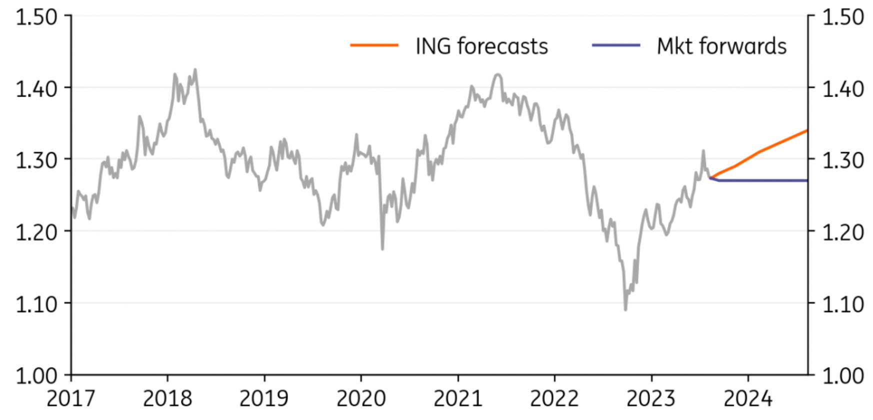
- As above, quiet markets this summer have favoured the carry trade. Popular funding currencies here remain the JPY and the CNY. Occasional bouts of risk off, like the bond sell-off in early August, will trigger brief short covering rallies in the JPY. But we need to see a sustained rise in volatility to upset the carry trade.
- July's tweak to the BoJ's Yield Curve Control (opaquely lifting the cap on 10yr JGB yields to 1.00% from 0.5%) has failed to lift the yen. No further BoJ change should be expected until late October.
- It looks like the BoJ will have to intervene again above 145 to limit USD/JPY topside and we assume our call for a weaker dollar in 4Q plus some further BoJ adjustments will send it back to 130.



GBP/USD: BoE expectations pared back - not quite enough

	Spot	One month bias	1M	3M	6M	12M
GBP/USD	1.2732	Neutral	1.28	1.29	1.31	1.34

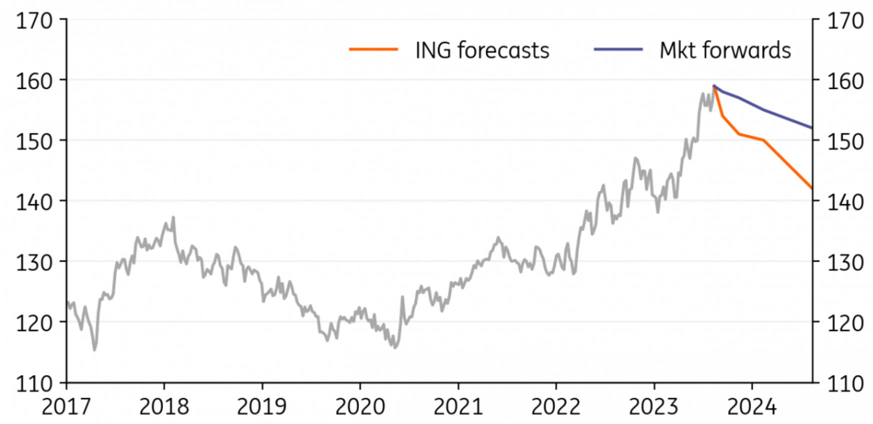
- The dollar's resilient performance in July has seen GBP/USD edge lower. That has been partially helped by the re-rating of the Bank of England tightening cycle, where the Bank Rate is now priced at 5.70% for next February - some 70bp lower than where it was priced at the start of July.
- The BoE is still sounding hawkish and barring a downside surprise to the July CPI or wage data, we look for one final BoE hike in September. But 5.50% should be the peak.
- As for the dollar, the carry trade is neutral for sterling given its 5%+ yields. And if we're right with the call for seasonal and cyclical $ weakness in 4Q23, Cable should be trading near 1.30.



EUR/JPY: Global soft landing keeps EUR/JPY bid

	Spot	One month bias	1M	3M	6M	12M
EUR/JPY	158.9200	Mildly Bearish	154.00	151.00	150.00	142.00

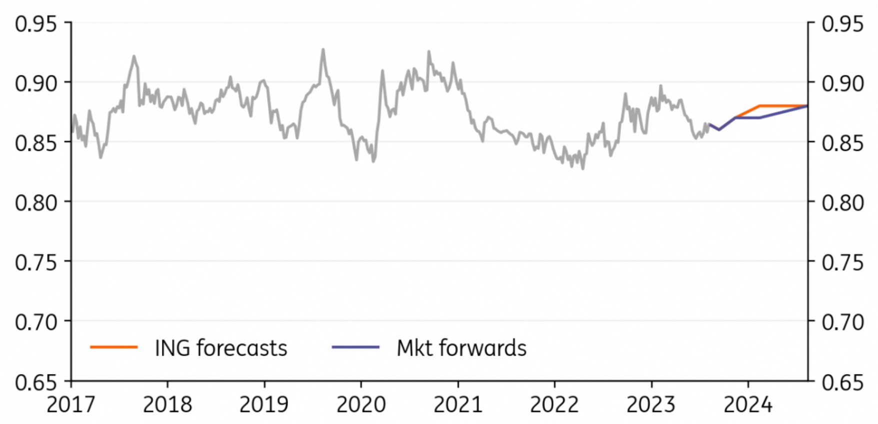
- As usual, equity markets seem to be climbing the wall of worry – whether those worries come from recessions or the prospect of some financial distress from, for example, China's property market. Instead, low unemployment rates are being seen as facilitating soft landings – which is a JPY negative.
- BoJ intervention in the 145-150 area in USD/JPY will occasionally interfere in EUR/JPY pricing, but it will take some global shock – or some very aggressive policy normalisation from the BoJ - to turn this EUR/JPY bull trend around.
- Arguably 2024 will be a more volatile year for risk assets as the November 2024 US elections come into view.



EUR/GBP: Don't write off further hikes from the ECB just yet

	Spot	One month bias	1M	3M	6M	12M
EUR/GBP	0.8638	Neutral	0.86	0.87	0.88	0.88

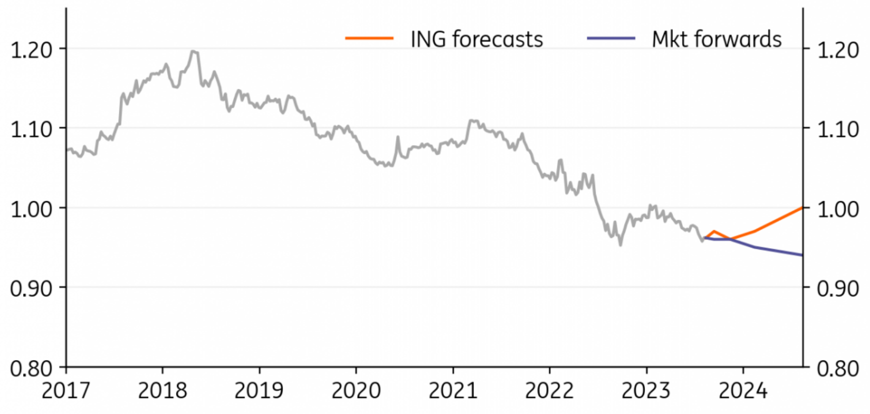
- EUR/GBP is nudging higher – largely on the back of the softer BoE pricing. Regarding the European Central Bank, the market prices 18bp of a 25bp rate hike by year-end – which is probably too little. We think the ECB will push ahead with a further hike in September despite activity levels starting to slow.
- The big question for the eurozone in 2H23 is whether activity levels slow as much as business surveys suggest. We think the ECB will have to downsize its second-half growth forecasts.
- Sterling should also be weighed by developments in the UK housing market, where the feed-through of higher policy rates into mortgage costs will be a pressing theme throughout 2024.



EUR/CHF: SNB is managing CHF stronger more quickly

	Spot	One month bias	1M	3M	6M	12M
EUR/CHF	0.9617	Neutral	0.97	0.96	0.97	1.00

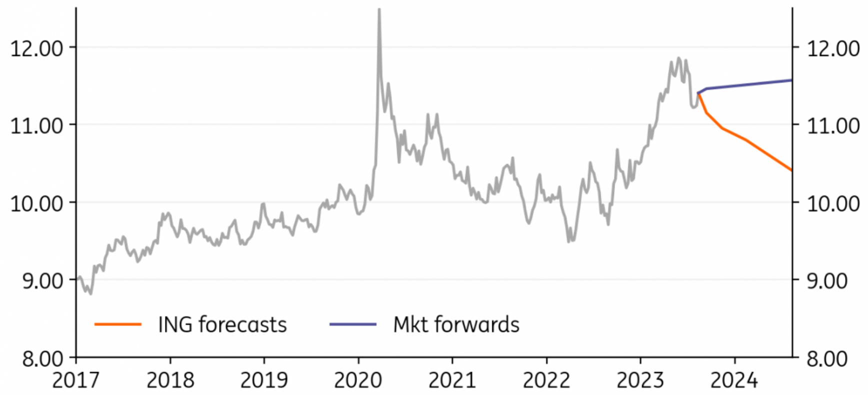
- Readers of this section will know that we spend a lot of time talking about the real CHF exchange rate and how the Swiss National Bank keeps it stable by selling FX reserves and guiding the nominal trade weighted exchange rate higher. Looking at the July CHF trade-weighted numbers released by the SNB, the nominal CHF is now 8% stronger YoY and the real CHF is 4% YoY stronger too. It almost seems as though the SNB wants an even stronger CHF.
- We do not see the 2Q23 FX intervention figures until the end of September, but FX reserves are still falling at a fast pace.
- The CHF is the strongest G10 currency this year (helped by the SNB) and EUR/CHF direction of travel looks to be to the 0.95 area.



EUR/NOK: No strong arguments against NOK recovery

	Spot	One month bias	1M	3M	6M	12M
EUR/NOK	11.4000	Bearish	11.15	10.95	10.80	10.40

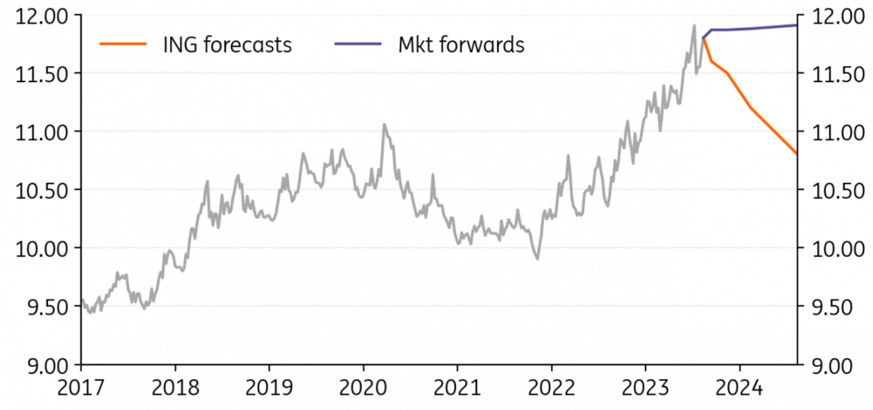
- We had been calling for the good fundamentals of the Norwegian krone to place it in an advantageous position once the market eyed the end of global tightening cycles. Now that we are observing some NOK recovery, we don't have strong arguments against it.
- It's worth remembering that the NOK is the least liquid G10 currency, so any shocks to risk sentiment would cause sizeable downside risks. Bumps on the road are possible (a temporary equity correction after the big rally, perhaps), but we expect high- beta currencies to attract more demand into year-end.
- Domestically, markets are underestimating the risks of another Norges Bank hike after August, and the economic outlook still looks resilient. EUR/NOK is on track to test 11.00 by 4Q.



EUR/SEK: Krona embedding a good deal of negatives

	Spot	One month bias	1M	3M	6M	12M
EUR/SEK	11.8000	Mildly Bearish	11.60	11.50	11.20	10.80

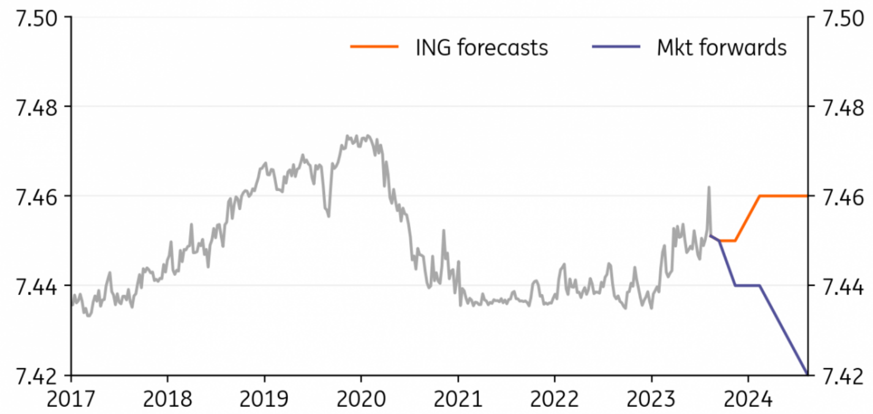
- The krona remains the G10 currency with most domestic risks. The SBB saga keeps generating worries on the real-estate market and financial stability, despite the recent rebound in house prices.
- Incidentally, GDP contracted more than expected (-2.5% QoQ in 2Q), and other economic indicators have stayed weak. Still, SEK is now pricing in most of these domestic risks: they should not dissipate soon, but the bar for new selloffs may be higher.
- Furthermore, inflation (especially core) has remained too sticky for the Riksbank to swing on the dovish side. Market expectations are flat after a September hike, so there is room for the RB to support SEK. We still expect EUR/SEK to trend lower by year-end.



EUR/DKK: Comfortable levels for the central bank

	Spot	One month bias	1M	3M	6M	12M
EUR/DKK	7.4511	Neutral	7.45	7.45	7.45	7.45

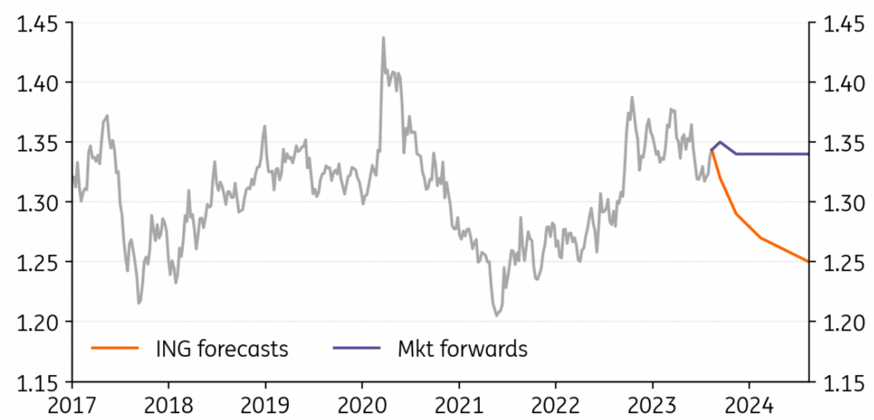
- Danmarks Nationalbank did not buy or sell DKK in FX interventions for the six straight month in July.
- EUR/DKK has continued to face some upside pressure after last month and was very little impacted by the DN decision to follow the ECB with a 25bp in July.
- The current levels (above 7.4500) are granting a safety cushion to the pair that should keep the DN away from FX interventions for longer, as well as probably disincentivise under-tightening compared to the ECB. In line with our ECB forecast, we expect one last hike in Denmark before the end of the year. EUR/DKK should keep trending modestly higher in the coming months.



USD/CAD: Bank of Canada tightening on ice

	Spot	One month bias	1M	3M	6M	12M
USD/CAD	1.3436	Bearish	1.32	1.29	1.27	1.25

- Data releases since the Bank of Canada July hike have been quite mixed. Headline inflation slowed more than expected, even though core stayed resilient, GDP numbers were strong, but July's jobs data showed a loss in net employment. The BoC should refrain from hiking again on the back of that.
- The rise in oil prices has been overshadowed by the unsupportive environment for high-beta currencies in the past month. CAD remains in a good position to recover, although its exposure to the US growth story could hinder gains further down the road.
- We take stock of the recent correction, but the chances of a break below 1.30 around the turn of the year as USD enters a steady decline pattern still look reasonably high in our view.

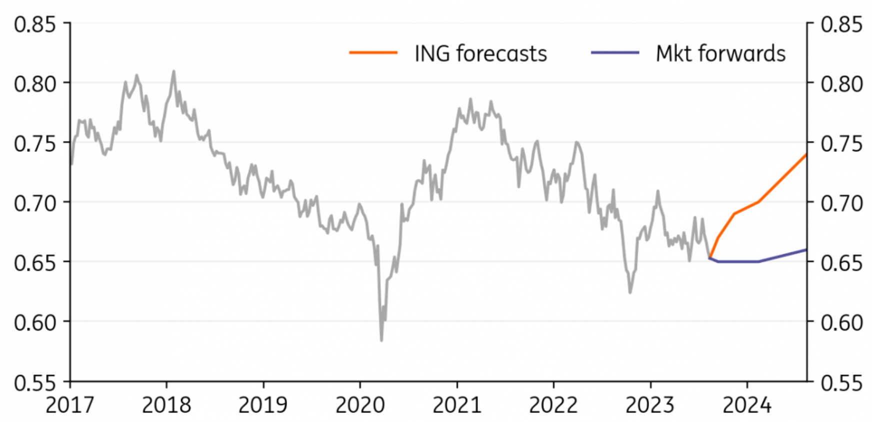


Source: Refinitiv, ING forecasts

AUD/USD: Lots to like about AUD

	Spot	One month bias	1M	3M	6M	12M
AUD/USD	0.6529	Mildly Bullish	0.67	0.69	0.70	0.74

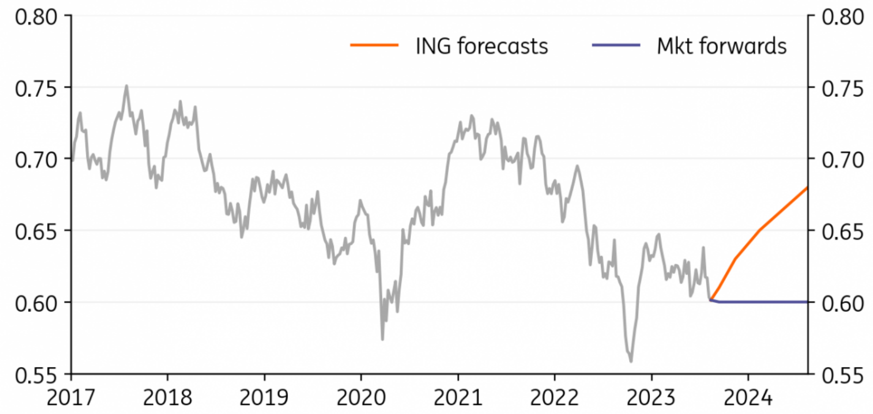
- The recent woes in the Chinese property market present some risks for all currencies exposed to China's sentiment, but AUD is already embedding a risk premium that we strongly believe is attributable to China's recent growth re-rating.
- Aside from that, we see plenty of reasons to like the Aussie dollar. Markets are under-pricing another RBA hike, which is our base case given upside risks to inflation and can benefit from an improved commodity picture and risk stabilisation later this year.
- AUD/USD is undervalued both in the short- and medium-term, and while USD could stay resilient for a bit longer, the end of Fed tightening should see AUD outperform in the coming quarters.



NZD/USD: RBNZ can't depress expectations much further

	Spot	One month bias	1M	3M	6M	12M
NZD/USD	0.6013	Mildly Bullish	0.61	0.63	0.65	0.68

- The Reserve Bank of New Zealand has had a chance to look at two key economic indicators since the July meeting: 2Q inflation and employment. The former was higher than expected, but broadly in line with the Bank's estimates despite showing unwelcome core resilience. Unemployment ticked higher, and wages rose less than feared.
- Inflation expectations failed to drop in the latest survey, but a deteriorating economic outlook should keep the RBNZ from sounding too hawkish at the August meeting.
- Still, markets are pricing no more hikes, and if anything, the risks are skewed to the upside for NZD. Like for AUD, NZD is embedding some China risk, and there is room for a recovery by year-end.



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