G10 FX Week Ahead: Steering clear of the bad eggs

The worsening Covid situation in Europe suggests the euro and Swedish krona may remain the “bad eggs” of the G10 after the Easter break. The dollar can continue to count on solid recovery prospects for now, but may start to see its upside limited against commodity currencies. In Australia, the RBA should retain its dovish stance without any surprises

USD: Riding the tailwind

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.1770	Mildly Bullish	92.8000 - 93.9000	93.0000

- The heavily Europe-weighted DXY continues to edge higher, driven by the yawning divergence in how the US and Europe have handled the Covid crisis. The US is moving ahead on its next fiscal stimulus plan and enjoying a successful vaccine rollout. Europe's keynote fiscal stimulus plan is stuck in a German courtroom and Europe is in the process of extending lockdowns. It is hard to see this narrative changing in the near term, where we expect the March nonfarm payroll jobs report on Good Friday to come in above 650k consensus. The week ahead will also see the March PPI readings, where understandably the focus is on rising input prices.
- The coming week will also see the release of the FOMC minutes on Wednesday and a variety of Federal Reserve speakers, including Fed Chair Jerome Powell on Thursday taking part in the IMF spring meetings. We doubt the Fed is yet ready to change its dovish tune and - as our bond team concluded at the time of the March FOMC - the Fed has left the long end of the bond market unprotected. Until we see some kind of turnaround in Europe, DXY should continue to edge higher – even to 94.50.

EUR: Gimme strength

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1748	Mildly Bearish	1.1630 - 1.1780	1.1700

- Diverging transatlantic trends continue to drive EUR/USD lower and it is hard to see what will change things near term. So far, support at 1.1700 has held, but a strong NFP and a further US Treasury market sell-off could be the catalyst for a break down to the low 1.16s. Providing some counter to this trend could be commodity prices this week, where upgrades to the IMF global growth forecasts (largely in the US and China) could prove supportive of the commodity complex in general and prove slightly dollar negative.
- The European calendar looks quiet during this holiday-shortened week, though some scrutiny could be given to the minutes of the March European Central Bank meeting released on Thursday. Here, the focus will be on how broad support was for the front-loading of the Pandemic Emergency Purchase Programme, which has since seen weekly net ECB PEPP buying rise to EUR19-20bn from a prior EUR12bn. We'll also see whether the EU's Recovery Fund can overcome the hold-up in the German constitutional court – which would at least be some welcome news. If not, expect serial EUR underperformance to continue.

JPY: Weakness a boon to the local exporters

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.69	Mildly Bullish	109.80 - 111.20	109.00

- USD/JPY has witnessed an incredible quarter, which should deliver some windfall gains to Japanese exporters and perhaps some outperformance of Japanese equities. Indeed, the Bank of Japan's Tankan diffusion index saw the component of Large Manufacturers in 1Q rise above zero and return to 3Q19 levels.
- Like the euro, the Japanese yen as a low yielder has borne the brunt of this year's dollar advance and apart from being overbought on a technical bias, there looks little to challenge the USD/JPY bull trend. Indeed, USD/JPY retains the highest correlation of any $ pair with US 10-year yields and the prospect (at some stage in 2Q) of US 10yr Treasury yields at 2% may keep USD/JPY supported. Locally the data calendar is light, although keep a close watch on 10 year JGB yields. The BoJ seems to be softening its control here and JGBs pushing above the highs of the year at 0.15% could in fact provide the JPY with a little support.

GBP: Solid domestic story, but weighed down by EUR/USD

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3791	Neutral	1.3650 - 1.3930	1.4400

- Although sterling continues to grind higher vs the euro, the EUR/USD decline dominates and has pushed GBP/USD down with it. Still, after Norway's krone, sterling seems to be the best placed currency in the European G10 FX space. The theme of the fast vaccination process remains intact and has been underscored by the start of easing of the restrictive measures in the UK. This is in sharp contrast with Europe, where restrictions are being extended and tightened further. We recognise the ongoing rise in GBP speculative longs (as per the CFTC data) but given the unique GBP position among European FX and the shift in the GBP trading pattern (away from frequent undershoots into undervalued territory to periods of frequent overshoots into overvalued territory as Brexit risk premium is being replaced by the vaccination dividend) the multi-month GBP/USD outlook is optimistic. Once EUR/USD stabilises / rebounds later this quarter, GBP/USD should push higher - back above the 1.40 level. But for the next week, GBP/USD is likely to stay range-bound
- It is a very quiet week on the UK data front. The March UK Construction PMIs (Thursday) should have a limited impact on sterling. GBP/USD direction will be largely about EUR/USD.

AUD: Dovish RBA unlikely to help the Aussie

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7579	Mildly Bullish ↗	0.7520 - 0.7680	0.7700

- The Australian dollar's soft momentum has driven AUD/USD below 0.7600, close to the December lows. Along with fears about the impact on the global recovery of new Covid waves (especially in Europe), a set of uninspiring data from China may have prompted some concerns about the pace of the recovery of Australia's main trading partner.
- AUD/USD is currently undervalued by around 3.0% in the short-term (according to our fair value model), which suggests the scope for further pressure on the pair should be more limited from now on. Next week, the release of the IMF growth estimates may provide some encouraging signals about the global recovery and benefit the commodity bloc of currencies as a whole. Domestically, all eyes will be on the Reserve Bank of Australia's meeting on Tuesday, although there is a high chance that it will be a non-event for markets. As discussed in our RBA meeting preview, the Bank should stick to its recent ultra-dovish tone, with the recent end of the government's Jobseeker wage-subsidy scheme likely adding more pressure to keep rates lower for longer considering the negative impact it is expected to have on the jobs market. The rate attractiveness of AUD is set to remain subdued, and may cause some underperformance in the crosses (especially in AUD/NZD).

NZD: No longer suffering from excessive long positioning

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6989	Mildly Bullish ↗	0.6940 - 0.7100	0.7300

- There are very few idiosyncratic factors driving the New Zealand dollar at the moment, after the fierce re-pricing of central bank rate expectations drove the currency in a downward spiral last week. The points we made in "Why we think the NZD drop doesn't have legs" to explain why we saw limited downside risks for NZD at this stage, remain valid. Rate expectations cannot drop further, the short-term undervaluation vs the US dollar is still material (around 2.9%) and the positioning is no longer overstretched to the upside. On this last point, the latest CFTC data showed that NZD net-longs had dropped even further in the week ending 23 March, suggesting much more contained room for a further long-squeeze in the currency.
- On the data side, there is not much going on in New Zealand until the next Reserve Bank meeting on 14 April. Next week, expect NZD to remain primarily driven by external factors, but the factors highlighted above suggest that room for a decent-sized rebound in NZD/USD is surely there.

CAD: Housing unlikely to become a key factor for the BoC just yet

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2588	Mildly Bearish ↘	1.2480 - 1.2650	1.2400

- The data flow in Canada continued to surprise on the positive side this week as GDP numbers for January beat expectations by displaying a 0.7% month-on-month increase. With markets attempting to guess how big the Bank of Canada will go in its tapering announcement (expected for 21 April), good data is clearly contributing to hawkish expectations. What we think, however, is that the state of the bond market around the date of the meeting could be a more important factor than the set of economic data in determining how large the tapering will be. This is because we expect the BoC to be very careful not to rock the already battered bond market in the process of unwinding its asset purchase programme.
- Some comments from BoC Governor Tiff Macklem about the dangers of rising housing prices in Canada attracted some attention this week. We learned from the case of New Zealand how the need to address a housing bubble can cause sharp movements in central bank rate expectations. We do not think this will be the case for now in Canada, and Macklem firmly highlighted this point by saying that macroprudential measures will come before any rate adjustment to tackle a housing bubble. Also, the rise in prices still appears relatively manageable: around 7% year-on-year – by comparison, in New Zealand prices were growing by nearly 20% YoY in January. To be sure, low borrowing costs are unlikely to help with the housing situation, but a BoC hike on the back of housing concerns is unlikely to be a story for the short-term. Looking at next week, the data calendar looks very quiet, and focus will be on how crude will behave following today's OPEC+ meeting and in light of fresh lockdowns in Europe. USD/CAD could press the 1.2500 support next week as the environment for commodity currencies may turn more positive.

CHF: No support from Polish mortgages

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1099	Neutral	1.1040 - 1.1120	1.1200

- While we're bullish EUR/CHF in the medium term (1.15 year-end forecast) there seems little reason for it to move much higher near term. Europe is struggling with Covid-19 and we need another big positive push on the global recovery story for those holding precautionary CHF longs to cut down their positions. We should probably also wait to see how the Polish ruling on CHF mortgages plays out (ruling 13 April) in case some Polish banks (very surprisingly) have CHF liabilities that still need covering.
- Elsewhere, an interesting story is developing in that the Swiss National Bank might have sold FX into February's EUR/CHF rally. That could free up some room for intervention later in the year, with perhaps the SNB now more wary of the US Treasury's currency manipulation threshold for FX intervention – and the currency manipulator tag already hanging over Switzerland. We doubt SNB FX sales would cap EUR/CHF – after all the SNB still describes the CHF as 'highly valued' – but it could slow the EUR/CHF up move.

NOK: Testing the EUR/NOK 10.00 level again

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.0400	Mildly Bearish ↘	9.9000 - 10.1540	10.0000

- EUR/NOK briefly pushed below the key 10.00 support level and we expect this psychological level to be tested again next week, particularly if we see an upward revision to the IMF global growth forecast next Tuesday. This is likely to support growth sensitive commodity currencies such as Norway's krone, with an added tailwind of the likely higher oil price.
- Domestically, the focus turns to the March inflation numbers (Friday). The underlying CPI measure should stay around 2.7% YoY while the headline CPI may see a modest decline to 3.2% YoY. Still, domestic price pressures are evident and with higher oil prices and the recovery of the domestic economy from late 2Q, the case for Norges Bank hike/s later this year remains intact. This is another tailwind for the NOK outlook for 2021.

SEK: Falling into meaningfully undervalued territory

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2800	Mildly Bullish	10.1400 - 10.3430	10.1000

- EUR/SEK pushed through the key 200-day moving average resistance level of 10.253, with the krona (a currency of a small open economy) feeling the weight of the deteriorating Covid situation in Europe and the falling EUR/USD. After the firm multi-month range bound trading, the move in EUR/SEK higher was quite substantial. Still, once the euro area and Swedish economies start their respective recoveries in late 2Q, EUR/SEK should dip lower, towards the 10.00 level. As EUR/SEK appears to be trading substantially overvalued based on our short-term fair value model (by around 2%), we look for some gentle recovery in the krona next week.
- Data wise, we have March PMI Services (Tuesday) and February industrial production (Thursday), but neither should have an impact on the currency next week.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Disclaimer