G10 FX Week Ahead: Fed to ECB: "Your move"

This week's ECB meeting presents an opportunity to strike back against the stronger EUR/USD. It seems too early for President Lagarde to borrow from the Trichet lexicon and describe the EUR/USD rally as 'brutal'. Yet concerns over the strong Euro's impact on Eurozone inflation – and the possibility for more stimulus – may put a temporary lid on EUR/USD

ECB President, Christine Lagarde

USD: Taking stock after a large decline

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.1720	Neutral	92.1000 - 93.3500	91.0000

- The DXY has found support near 92.00 and that may be enough for the time being. DXY losses should be held in check ahead of Thursday's ECB meeting, where it will have the first opportunity to respond to the Fed's change in monetary policy strategy. We've already seen the Riksbank, for example, speculating over their own version of average inflation targeting. Assuming the ECB doesn't surprise with some concrete signals of imminent easing, we suspect that DXY rallies are sold into and it could come under further pressure post ECB.
- After Monday's US Labor Day holiday, the focus next week will be NFIB small business optimism on Tuesday and then the CPI figures on Friday. In theory, CPI figures should move the market far less than before, now that the Fed is prepared to run the economy hot, but any upside surprises may more be felt through the long end of the Treasury market – perhaps helping USD/JPY the most.

EUR: How bothered is the ECB with a strong Euro?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1802	Neutral	1.1750 - 1.1950	1.2000

- The stand-out of the week ahead will be Thursday's ECB meeting. No doubt the strong EUR will be a hot topic as will the issue of the Fed's change in monetary policy strategy. On the former, we've have started to see some soft verbal intervention against EUR strength and the focus at the meeting will be: i) how much lower does the ECB revise its 2022 inflation forecast (now 1.3%) and ii) will it start dropping hints about future easing?
- Given broad momentum behind dollar weakness we think the ECB can only slow, not reverse EUR/USD appreciation. We therefore look for some consolidation ahead of Thursday's ECB meeting, but expect investors to buy the dip. Local data for the week ahead will be a look at July industrial production figures across Europe and the Sentix Investor Confidence survey, expected to improve further.

JPY: Suga-coated

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	106.39	Neutral	105.50 - 106.80	104.00

- Developments in Japanese politics suggests that PM Abe will be replaced by close ally and Cabinet Secretary Suga. This should deliver continuity in Abenomics – i.e. the loose fiscal, loose monetary mix that has dominated Japan since 2012. This has done little to trigger a sustainable rise in inflation, yet this has kept the JPY relatively soft. The election for the new LDP leader takes place on 14 September.
- The week ahead in Japan sees final 2Q20 GDP, the July BoP figures and core machinery orders. With challenges to the V-shape narrative expected to emerge over coming months, we expect the JPY to start outperforming on the crosses and suggests USD/JPY will struggle to sustain gains over 107.

GBP: Sterling upside stalling

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3210	Neutral	1.3050 - 1.3400	1.3200

- Another round of UK-EU trade negotiations starts next week, but we expect a little break through. The main divisive point remains state aid and we don't expect the UK to present an acceptable proposal for the EU next week. The October deadline for trade negotiations looks likely to be breached and with no imminent breakthrough in negotiations, the negative headline news is likely to increase. Coupled with the near-term limited upside to EUR/USD (following the comments from ECB officials and the likely more easing from ECB ahead), the recent GBP/USD rise should stall, with the pair unlikely to breach the 1.3500 level again any time soon.
- We note the importance of EUR/USD for GBP/USD price action, with the former explaining almost 100% of the move of the latter over the past three months. On the UK data front, July GDP (Friday) should point to an economic rebound of 6-7% during the month as many lockdown measures were eased. Still with the UK economic outlook highly uncertainty (both on the Covid and UK-EU trade negotiation fronts) the bias remains for eventually even looser BoE monetary policy (likely in November).

AUD: Stabilizing risk sentiment helping AUD

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7252	Mildly Bullish	0.7170 - 0.7380	0.7100

- The September RBA meeting proved to be a non-event with the central bank not expressing any urgent discomfort with the ongoing currency appreciation. The week ahead will be rather calm on the domestic data front, with AUD likely looking through both Business and Consumer confidence readings (Tuesday and Wednesday, respectively).
- Despite the Covid-related lockdown in Victoria, AUD price action remains primarily determined by the global risk sentiment. The currency was one of the main underperformers this week as risk appetite turned, but our neutral / constructive outlook for risk next week (primarily to be helped by the cautious ECB on Thursday) suggests AUD/USD should stay above 0.7200 and in fact grind modestly higher.

NZD: Calm week ahead, with NZD stabilising

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6690	Mildly Bullish	0.6600 - 0.6800	0.6700

- It is a quiet week on the New Zealand data front. Sep Business confidence (Wednesday) and Aug Manufacturing PMIs (Thursday) should have a muted impact on NZD.
- The expected stabilisation in risk sentiment should put a floor under the recent, thought short-lived, NZD/USD decline, with the pair set to grind modestly higher next week. On the downside, the 50-day moving average of 0.6599 should prove a strong support level Given the ongoing non-negligible threat of RBNZ negative interest rates, NZD should be underperforming AUD in risk on environment.

CAD: No surprise from the BoC

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3110	Mildly Bearish	1.2990 - 1.3210	1.3100

- The Bank of Canada is set to keep interest rates unchanged at 25bp next Wednesday. With the high frequency indicators pointing to some levelling off in activity recently, this suggests the BoC should retain its dovish bias, especially with inflation remaining benign given the large output gap. With no material surprise coming or the BoC shifting its stance, the impact on CAD should be negligible next week.
- Along with other cyclical currencies, CAD seen a correction lower following the equity market rout. Our base case for some stabilisation in equity markets, and short-lived and limited spill over into FX (as already seen today) suggests a neutral / modestly bullish view on CAD next week. USD/CAD to move closer to the 1.3000 horizontal support level next week.

CHF: Domestic confidence is booming

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0800	Neutral	1.0730 - 1.0850	1.0700

- We're still watching developments in USD/CHF carefully, where the 0.90 level seems to be holding and sparking occasional spikes above EUR/CHF above 1.08. Is this Swiss National Bank FX intervention? Could be. On the subject of intervention, Switzerland releases August FX reserve data on Monday and could show another rise if CHF sight deposits are anything to go by?
- Elsewhere, we'll also see the August unemployment rate – expected to nudge up to the 3.4% area. Despite this, Swiss consumer and business confidence is proving astoundingly strong – but not strong enough to alter the SNB's ultra-dovish stance as it continues to battle deflation (currently -0.9% YoY).

SEK: The steady force in the G10 FX space

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3660	Neutral	10.2870 - 10.4400	10.2000

- Domestically, the focus of the week will be on Swedish August inflation (Thursday). Headline CPI should edge a little higher due to oil prices, while core CPI should remain stable. With Riksbank already signalling a prolonged period of unchanged interest rate (and the bar for interest rates turning negative again being set rather high), this should have a limited impact on SEK. The main driver of the currency remains the global risk sentiment, suggesting at least a neutral bias for EUR/SEK next week
- While the SEK felt the heat from the equity market sell off and the drop in EUR/USD, the outlook for the currency remain constructive as the small open economy of Sweden is to benefit from the improving outlook for global growth (in contrast to prior years, when improving global trade failed to spill over into stronger SEK as Riksbank leaned against the currency appreciation – but this is not case at this point).

NOK: Still high inflation, but no prospects of a response from the NB

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.5740	Mildly Bearish	10.4600 - 10.6620	10.5000

- The August underlying inflation should remain fairly stable around 3.5%YoY (with inflation being high due to the weaker NOK during the previous winter). Still, any policy tightening remains a distant possibility given the Covid-19 related uncertainty as well as Norges Bank's concerns about the wage growth and how much it may weaken this year. Hence, the spillover into NOK should be rather limited.
- With NOK exerting the highest beta to risk in the G10 FX spectrum, we see a modest upside to NOK next week, particularly if the prospects of even looser ECB monetary policy keep risk appetite supported.

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