G10 FX Week Ahead: Not too much light at the end of the tunnel

The bond sell-off is prompting some position-squaring in the oversold dollar, which may remain supported in a week where the release of US CPI numbers may leave bonds vulnerable. The ECB meeting will be centred around any possible verbal intervention against rising yields, and the Bank of Canada should leave its policy message unchanged

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USD: Bear market bounce has a little further to run

	Spot	Week ahead bias	Range next week	1 month target
DXY	91.9500	Mildly Bullish	91.2000 - 92.5000	91.0000

- The scale of the US Treasury sell-off remains the only game in town after a week in which Fed Chair Powell expressed little concern over higher US yields and the February NFP came in stronger than expected. The speed of the rise in US yields is impacting positioning – especially short dollar positioning – and until we begin to see a little stability in Treasuries, the risk is that this bear market bounce in the dollar runs a little further. In the week ahead, US Treasuries will have to weather February CPI (YoY headline rising to 1.7% from 1.4%) on Wednesday and PPI on Friday. US Treasuries may well also face headwinds from 10yr and 30yr auctions on Wednesday and Thursday, plus Michigan consumer inflation expectations on Friday. Here 5-10 year US inflation expectations currently sit at 2.7% and any higher might start catching the attention of the Fed.
- In all, the unchecked rise in US Treasury yields can keep the dollar supported for the short term, but when Treasuries find the 'right level', we expect investors to jump back into pro-recovery/weaker dollar trades. However, it does not seem that we are quite at that point yet.

EUR: Bonfire of the low yielders

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1920	Mildly Bearish	1.1825 - 1.2020	1.2200

- The jump in US yields was finally enough to take out support at 1.1950 on Friday and until confidence emerges that Treasuries have sold off enough, a speculative market positioned reasonably long EUR/USD looks vulnerable. In effect this rise in US yields has shaken long positions held in the defensive low yielders of first JPY, then CHF and now it looks like the EUR. Failure to quickly reclaim 1.1950 on a sustained basis leaves EUR/USD vulnerable to a further drop to the 200-day moving average near the 1.1825 area.
- The Eurozone calendar this week centres on the ECB. Expect much focus on what Christine Lagarde thinks of the bond sell-off. Initially the ECB seemed to be prepared to front-load PEPP purchases to contain the rise in yields, although most recently ECB speakers have backed away a little from this concern. On that subject, Monday's APP report will again be scrutinised to see if PEPP activity did increase in the prior reporting week. For the ECB meeting itself, expect a modest downward revision to 2021 GDP forecasts and an upward revision to CPI forecasts, but probably not enough to make a material difference for the EUR.

JPY: Ain't no stopping us now

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	108.30	Neutral	107.80 - 109.20	105.00

- Once again, we find ourselves saying that we have underestimated the size of this USD/JPY rally. Perhaps it is because this sharp rise in US yields has yet to seriously undermine equity markets – which remain resolutely bid. In fact, it seems equity investors are happy to rotate into financials (enjoying steeper yield curves) at the expense of Tech.
- It is hard to see the above dynamic changing, thus we'll have to brace for further upside in USD/JPY. As an aside, politicians in Tokyo must be enjoying this trade weighted JPY decline, standing in a good position for when the surge in foreign household savings get spent. A new Japanese car anyone? On the Japanese calendar is January BoP released Monday. This looks huge near JPY2 trillion per month and a reminder that if the risk environment does briefly turn toxic, the JPY should make a strong comeback.

GBP: Ongoing correction, but outlook remains upbeat

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3820	Mildly Bearish	1.3680 - 1.4020	1.4400

- GBP has been hit by another sharp rise in UST yields, yet it has been weathering the storm relatively well, outperforming other European currencies with the expectation of the oil exposed NOK. We continue to see the recent GBP/USD wobbles as risk sentiment / positioning induced correction rather than a change in the trend. Once the dust behind the sharp spikes in UST yields settles and risks appetite stabilizes, GBP/USD should move back above 1.400 level (we target 1.50 later in the year). As for the next week, the possible further rise in UST yields remains the risk to GBP/USD. The 50-day moving average level of 1.3750 is the next key support level to watch.
- It is a quiet week on the UK date front. Our economists expect Jan UK GDP (Friday) to fall by 5%, driven predominantly by the closure of several consumer service sectors. This is a backward-looking indicator and should have a limited impact on GBP, particularly in light of the fast vaccination and the anticipated strong economic rebound in 2Q. The tensions over the UK unilaterally softening trade restrictions in the Irish Sea haven't hit GBP so far, with the general risk sentiment and the fast UK vaccination process dominating the GBP price action.

AUD: RBA could step in with more intervention soon

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7680	Mildly Bearish ↘	0.7580 - 0.7650	0.7600

- The Reserve Bank of Australia's interventionism in the bond market will remain a key focus next week. After the big purchase operation on Monday, the Bank has kept purchases lighter late this week despite the fresh spikes in yields. That, in our view, is not signalling a change of stance, and we expect the RBA to continue intervening in the market as necessary to defend its yield target.
- The week ahead is not very busy data-wise, but some focus will be on RBA Governor Philip Lowe's speech on Tuesday. Comments related to the Bank's yield-curve defence may however have contained market impact: verbal intervention would not be seen as very relevant (unless a very strong commitment to defending yields is made) after the bank has already deployed operational intervention. AUD has survived a strong week for USD, but the monetary policy and rate gap still argues in favour of some underperformance vs the likes of NZD in the coming weeks.

NZD: External factors dominate

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7150	Mildly Bearish ↘	0.7070 - 0.7200	0.7300

- This week's NZD underperformance was likely exacerbated by some long-covering and Auckland facing another 7-week lockdown. On the latter, short local lockdowns have so-far been a successful tool of curbing infections in NZ, so we could see Auckland comfortably moving back to normality.
- Otherwise, NZD does not show any clear idiosyncratic catalysts for next week and should continue moving in line with global risk appetite, with the global bond sell-off remaining the key story to watch. The release of the OECD interim growth outlook on Tuesday may also be a key event for risk sentiment and pro-cyclical currencies next week.

CAD: BoC should steer away from tapering chatter

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2670	Mildly Bullish	1.2600 - 1.2730	1.2500

- A rebounding economy, rising inflation expectations, oil prices giving fresh recovery hopes to the battered Canadian energy industry and contained contagion numbers would all argue in favour of starting to unwind QE. Indeed, we think, and consensus appears to be on the same side, that the next move by the BoC will be to taper its bond purchases.
- At next week's meeting, however, in the middle of a fierce bond sell-off, Governor Tiff Macklem will likely have no interest in endorsing any tapering expectations. We expect the BoC message to be broadly in line with the recent Fed's rhetoric: stressing that monetary stimulus is here to stay. This means that the market (and FX) impact should be limited, unless Macklem opts for a more alarmed rhetoric (i.e. verbal intervention) on the volatile bond environment. Data-wise, jobs figures for February may follow the US ones higher, and keep the domestic narrative supportive for CAD. Oil price momentum will be tested after the boost from the OPEC+ this week: a pause in the crude rally may be on the cards, but prices may well have a new floor now.

CHF: Long and wrong

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1090	Neutral	1.1050 - 1.1150	1.1200

- This last week has seen EUR/CHF push further ahead. There was no clear catalyst for the move, yet we suspect speculative long CHF positions have been downsized. This should show up in the CFTC reports released over coming weeks. And our best read is that there is much more position adjustment to occur here – keeping the CHF vulnerable.
- The Swiss data calendar is very light this week, but we will get some fresh economic forecasts from SECO, the Swiss government's economic affairs office. Most recently this had forecasted Swiss growth at 3.0% in 2021 and 3.1% in 2022. It is not certain that the 2021 forecast will be upgraded given the sluggish start to the year from the Eurozone. But let's see.

SEK: Remaining relatively well behaved

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1760	Mildly Bullish	10.0960 - 10.2580	10.1000

- Although SEK is under a modest depreciation pressure, we expect any break above the EUR/SEK 10.200 level to be short-lived. While the Riksbank outlook is clear (cautious central bank is not intending to raise rates over the forecast horizon), the medium-term SEK view is positive as the currency should benefit from the European economic recovery from 2Q onwards. The krona's relatively lower beta (vs other cyclical G10 FX peers) also makes the downside to SEK vs EUR in the current risk challenging environment limited.
- It is a very quiet week on the Swedish data front next week. Jan industrial production (Tue) and Feb unemployment rate (Thu) won't have any impact on SEK, with the global risk sentiment (and the pace of the UST sell-off) to be the prime driver of the krona.

NOK: Rising oil price balancing the external negatives

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.2130	Neutral	10.1000 - 10.3370	10.2000

- Although the high beta, low liquid NOK is usually vulnerable during the periods of UST sell-off / lower equity markets, the rise in the oil prices is balancing the negatives. Given the challenging risk environment and the dollar strength, the fact that EUR/NOK is around 10.20 is rather stunning. The non-appreciating NOK, higher commodity prices, the expected growth rebound from late 2Q onwards and high inflation all mean that the bias is skewed towards a more hawkish Norges Bank in coming months and earlier rate hikes. The subsequent recent rise in market expectations of NB hikes is also providing additional support to NOK during the current challenging environment for risk
- The expected rise in Feb CPI (Wednesday) should be beneficial for NOK as it will validate the hawkish market expectations of the NB path. Generally, although we expect the market environment to remain challenging next week, the above factors should be mitigating this possible negative spill over into NOK.

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