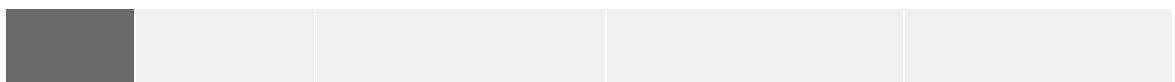


G10 FX Week Ahead: China, reflation and the dollar's slippery slope

An agreement on the US relief package, fierce retaliation by China and more data feeding into the reflation narrative may all be on the cards next week. But we suspect investors (who are increasingly looking at the possibility of negative rates by the Fed) may hold a “sell-the-rally” stance on the USD. Elsewhere, the RBNZ may adjust the size and shape of its QE



USD: Bracing for a China back-lash?

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.5600	Mildly Bearish 	92.5000 - 93.8000	91.0000

- Friday's NFP jobs data supported the narrative of recovery and US data in the week ahead is expected to do likewise. We're looking for another rise in NFIB small business confidence, CPI to drift higher and a slightly above consensus rise in July retail sales. However, our US economics team are concerned that the re-closure of parts of the US economy and delays of the fourth stimulus package means that the August data, released in September, will take a turn for the worse.
- Probably more dominant for the dollar will be two key issues: i) is there any progress on the Phase IV stimulus plan and ii) how does China retaliate to the latest sanctions from the White House, possibly including against HK Chief Executive, Carrie Lam. The rally in Asian FX (including the Renminbi) has been helpful to the broader dollar decline, thus a sharp re-opening of political tension could favour dollar consolidation/correction. However, investors are really sinking their teeth into the negative US real yield story ahead of the 16 Sep FOMC meeting and we suspect that any corrective dollar rallies (even if they are violent) are short-lived.

EUR: Temporary setback

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1760	Mildly Bullish 	1.1630 - 1.1850	1.2000

- EUR/USD looks as though it has entered a brief period of consolidation. Given the huge cross-correlation in reflationary assets these days (including a possible bubble in silver), the risk is growing of a short, sharp correction. There is outside risk that EUR/USD quickly trades down to the 1.1630/50 area – e.g. were US-China tension or continued failure over the Phase IV stimulus to trigger a stock market correction. Yet we expect willing buyers to emerge under 1.17, looking for 1.20.
- Eurozone data this week includes investor sentiment data for August, July Eurozone industrial production and the first revision to some of the 2Q20 GDP data. Our team feel that sectors outside retail, including the industrial sector, maybe a little slower to recover – thus softening the V shape narrative. In all, however, EUR/USD should be dominated by events in Washington and Beijing, including any Fed speakers providing any insights into the average inflation target debate.

JPY: Looking out for the bond buyers

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	106.00	Mildly Bearish 	105.00 - 106.20	103.00

- USD/JPY has returned to trading narrow ranges after recent excitement. A hot topic is the idea of Japanese fund managers doing some of the government's work by buying USD/JPY below 105. The latest MoF data did show a pick-up in Japanese foreign bond buying – though it is too early to say if this is a sustained trend. What we do know, however, is that if the Fed is successful with its 'opportunistic reflation' exercise – keeping rates low, driving inflation higher – then USD/JPY should be headed towards 100.
- Local data sees the June current surplus released. The market is expecting a renewed pick-up here after a collapse during the crisis. A healthier balance would add to the negative USD/JPY story.

GBP: GDP and employment to pour cold water on the GBP rally

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3017	Neutral	1.2850 - 1.3100	1.3100

- GBP enjoyed a small rally on BoE-day, but the rally is already fading. The week ahead could pour some cold water on some emerging GBP optimism. Here the focus will be on: i) June employment figures and ii) 2Q GDP. On the former, the market expects unemployment to rise to 4.2% from 3.9%. Getting a good handle on the employment situation is hard because of the furlough scheme (12 million having taken advantage of it), but the BoE is eventually expecting the u. rate to hit 7% plus. On GDP, the market expects a 20% QoQ contraction. The BoE is slightly more optimistic. Let's see.
- While acknowledging the market is short GBP and subject to a squeeze, we think there is outside risk of a Cable correction to the 1.2850 area, before it returns to challenge 1.32 on the weak dollar story. Any upside surprises to GDP/employment story would clearly undermine that view of a correction.

AUD: Jobs and virus in focus

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7166	Neutral	0.7115 - 0.7235	0.7100

- The Reserve Bank of Australia meeting was no game-changer for the AUD, but the Statement on Monetary Policy released on Friday was characterized by a rather downbeat view on the economic recovery, with the growth forecasts for 2020 downgraded to -4% and the unemployment rate seen peaking at 10%.
- The jobs report is the key highlight in the Australian calendar next week, as the rebound in employment is expected to have slowed in July. It will be key to monitor any signs of life in full time employment. Still, most eyes will be on the developments in the contagion curve in the State of Victoria. In FX terms, we continue to see AUD as the commodity currency bearing the biggest risk of a correction if market sentiment shows more fragility, especially in the case of further escalation in US-China tensions.

NZD: RBNZ may re-adjust its QE

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6611	Neutral	0.6560 - 0.6660	0.6700

- The Reserve Bank of New Zealand will hold its monetary policy meeting on Wednesday and we expect (along with consensus) no changes to the policy rate. Still, there is an increased chance that the Bank will decide to adjust both the size and shape of its quantitative easing programme to add further monetary stimulus ahead of peaking bond issuance.
- The Large Scale Asset Purchases (LSAP) programme is already providing the purchase of up to NZD60bn, but has often reiterated the openness to review the volume of total purchases. A boost in the size of the programme may be followed by the alignment with the RBA's yield curve control, although there have not been clear indications in this direction. NZD will be particularly reactive to any currency comments as the RBNZ has already highlighted on more than one occasion its negative impact on imports. The threat of negative rates should remain in place (possibly, with the aim of curbing NZD appreciation), but we are still reluctant to see the Bank embarking into such policy. All in all, the impact on NZD of the rate announcement could be broadly balanced, and markets will remain focused on US-China tensions given the high NZD exposure to China.

CAD: Data offering room for consolidation

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3390	Neutral	1.3300 - 1.3450	1.3300

- The Canadian economy kept rebounding in line with the US as employment rose by 419k in July (above consensus) and the unemployment rate dropped to 10.9%. The loonie has had a fairly good week and may positive news on the data side may form a base for additional catch-up with its procyclical peers' recent gains.
- Next week is not offering catalysts data-wise in Canada, and the loonie will be highly reliant on geopolitical developments driving risk sentiment. An agreement on the US fiscal stimulus package might also provide some positive spill-over on CAD, which may incidentally need clear signs of slowing US contagion to unlock more upside.

CHF: USD/CHF still the key

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0766	Neutral	1.0720 - 1.0820	1.0700

- Tight ranges are back in vogue and not until we see an equity market correction should we expect much of a trend. Notably European sovereign debt markets seem very comfortable right now and European political worries look to have been kicked later in to the year,
- USD/CHF is our key focal point here. We favour a 0.90-0.92 trading range and then a break down to the 0.87/0.88 area - with USD/CHF being a key vehicle to express the negative US real yield story. The local Swiss calendar is very light.

SEK: Limited impact from inflation numbers

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3010	Mildly Bearish 	10.2300 - 10.3400	10.2000

- The inflation report will be centre stage in the Swedish economic calendar next week. Consensus is looking at a slowdown to 0.2% in both the headline read and the CPIF. While inflation numbers are generally a high-impact factor for SEK, the slowdown in inflation will hardly convince investors that the Riksbank will drop its reluctance to re-embark in negative rates. This is especially true after GDP numbers showed a less severe contraction compared to the major economies of the eurozone.
- Markets will also keep an eye on the Prospera Inflation expectations survey, but still the market impact should be limited. SEK should retain its resilience to swings in risk sentiment and be a pro-cyclical outperformer if US-China tensions escalate much further.

NOK: Still in need of oil resilience

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.6660	Neutral	10.5500 - 10.7700	10.4000

- NOK has led gains in G10 this week, as it continues to recover its pandemic losses and showed good resilience to fragility in global risk sentiment. Next week, CPI numbers for the month of July will be released. Barring extremely surprising reads, the release should have a limited impact on the currency as any Norges Bank policy normalisation plan does not look like a story for the foreseeable future.
- The ability of Brent to consolidate above US\$45/bbl now appears key to keep fuelling NOK momentum.

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

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.