G10 FX Week Ahead: Running out of road

It is a very close call, but we still think a Brexit deal can be agreed, with the risk of negotiations dragging beyond Sunday's deadline. Next week will also be about central banks: the Fed should keep the punchbowl in place, the BoE's tone will depend on Brexit and the SNB should reiterate the threat of FX interventions. We expect the bearish USD mood to linger

DXY: Fed keeps the punchbowl in place

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.9680	Mildly Bearish	90.2000 - 91.2000	90.0000

- FX markets will start the week buffeted by Brexit news and also whether there has been any progress on a US stimulus bill – perhaps as well concerns over a government shutdown. With the US struggling with the pandemic, however, one assumes that Congress would want to avoid a shutdown at all costs. As the week progresses, the focus will shift to Wednesday's FOMC meeting. Our team expect a dovish message to be maintained as well as perhaps some forward guidance on the Fed's asset purchases. The Fed is an experienced communicator and we doubt it will make any mistakes over misconstrued words on premature removal of stimulus.
- The US data set sees November industrial production and retail sales as well as the weekly focus on (now rising) initial jobless claims. All should point to the need for continued loose monetary and fiscal policy. Despite the risks to the consensus view of a weaker dollar, we do not really see this underlying trend changing anytime soon – and indeed it could extend were Brexit negotiations to reach a break-through. Also look out for Chinese November industrial production figures on Tuesday. Chinese demand has been driving the commodity FX bloc stronger and adding to the broad dollar bear trend.

EUR: Bound by Brexit

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2116	Mildly Bullish	1.2050 - 1.2250	1.2200

- Were it not for Brexit, we think EUR/USD would be trading 1.23 by now. Presumably, GBP will be dragging EUR around by the nose on Monday morning, driven by any progress – or lack thereof – on Brexit discussions. But given: a) the powerful dollar bear trend and b) EU leaders having approved the 2021-27 budget and Recovery Fund and c) the ECB meeting having passed, we believe EUR/USD should stay supported. That said, the ECB will occasionally remark that it is watching FX markets 'very carefully' or is 'very vigilant' on FX, but we doubt these remarks can put a lid on EUR/USD.
- Away from fiscal and monetary decisions in Washington and the Brexit deliberations in Brussels, the Eurozone calendar is relatively light this week. We'll see October Industrial Production on Monday and then the first look at the December PMIs for the Eurozone, Germany and France on Wednesday. Lockdowns have taken their toll on the service sector and from the looks of it, consensus expects little rebound here in December.

JPY: BoJ to keep its foot on the accelerator

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	104.05	Neutral	103.50 - 104.50	102.00

- USD/JPY has dipped into narrow ranges and didn't get a lift this last week since US yields were well contained. Clearly the Fed will generate some volatility here this week and any Fed mis-steps could see US yields and USD/JPY both press the upside. But a baseline view would see US 10-year yields stay sub 1% the week ahead – limiting USD/JPY's upside.
- Local Japanese interest this week comes in the form of the 4Q Tankan business survey – expected to recovery from very low levels – and then Friday's BoJ meeting. Here the focus will be on the BoJ extending schemes to keep corporate credit costs low at a time when Japan is still battling with Covid-19. No change is expected in any of the key BoJ levers on rates or JGB yields, however. We're neutral on USD/JPY, but if we're wrong on a Brexit deal being reached, look for JPY outperformance – just as was the case in summer 2016, when this all began.

GBP: The waiting game continues

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3170	Bullish	1.2930 - 1.3700	1.3600

- While a very close call, we continue to think the UK-EU trade deal is more likely than not. We can easily see the negotiations dragging beyond this Sunday (which would be in line with the recent trend of breaking yet another deadline) but the deal should eventually be reached, with a possible compromise on the level playing field and agreeing on the so-called ratchet clause (where both sides mutually agree to raise standards). We see an asymmetric GBP reaction function to the UK-EU trade negotiation outcome, with modest upside in the case of a deal but profound downside in the event of no deal as fairly limited risk premium is currently priced into GBP. This is evident in our short term financial fair value model as well as in speculative positioning.
- On the data front, the BoE meeting is on Thursday but as the outcome of the Brexit negotiations may not be known, the central bank should keep its policy stance unchanged. Moreover, with the Bank already extending its QE programme, there is no urgency to do more, unless the Brexit negotiations turn sour and the UK heads for the no deal. But overall, as we see the deal more likely than not, once/ if reached, this should provide an upside to GBP/USD and push the cross above the 1.35 level, towards 1.37.

AUD: Cast-iron momentum

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7540	Mildly Bullish	0.7480 - 0.7630	0.7400

- AUD/USD has moved above the 0.75 mark this week thanks to a combination of resilient risk appetite, rallying iron ore prices and a generalized weak USD environment. Looking at the coming week, such combination of external factors may continue to offer support to AUD despite the risk of a temporary correction in risk assets worldwide if no-deal Brexit prospects materialize over the weekend. Looking beyond the short term, we think the push from iron ore rallies may run out of steam in the new year on the back of supply normalisation and shrinking demand from China. Meanwhile, Beijing has continued to escalate the trade spat with Canberra by hitting Australian wine with more duties. For now, AUD remains unreactive to the whole story, and this may continue to be the case unless China steps up and threaten to hit iron ore, Australia's main export.
- On the domestic side, November employment data will be watched in Australia along with the RBA minutes from the December meeting. On the first one, our economics team expects only a marginal tick-up in unemployment to 7.1% as hiring might have slowed to around 50k in November. We don't see such levels of unemployment having clear implications for the Reserve Bank of Australia monetary policy, and we remain of the view that the easing cycle has likely peaked. The December RBA minutes may go down as a non-event considering the meeting was quite uneventful itself. As usual, AUD may be quite reactive to any currency-related comment in the minutes: so far, the RBA has held a fairly relaxed stance towards AUD's strength.

NZD: Weaker GDP rebound than expected?

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7090	Mildly Bullish	0.7030 - 0.7180	0.7000

- As we expected, the Kiwi dollar has started to trail behind AUD, mostly due to the fact that the re-pricing of negative rates by the Reserve Bank of New Zealand is now over. Also, NZD still displays an asymmetric net-long positioning (according to CFTC data), which suggests a more contained room for further rallies. Nevertheless, while AUD may remain the better performer in the region, NZD/USD can still benefit from supported risk appetite and weak USD to keep inching higher.
- On the data front, NZ 3Q growth data will be the highlight of next week. The release should highlight a significant clawback in activity after the very severe 2Q slump, although we see the risk of the actual figure falling short of the upbeat consensus expectations. Barring a very grim read, this should still hardly revamp any expectations around more RBNZ rate cuts, and the impact on NZD may therefore be fairly short-lived.

CAD: Better inflation outlook no big help to the loonie for now

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2760	Mildly Bearish ↘	1.2640 - 1.2820	1.2800

- USD/CAD failed to break below 1.27 this week but still remained generally pressured. We believe that some quite extensive short-squeezing has helped CAD of late, and while this may not appear evident in positioning data just yet, we are inclined to think CAD has now a more balanced positioning. Still, CAD has more to benefit from further global equity outperformance, better recovery prospects as a vaccine will start to be rolled out in North America soon and from the recovery in oil prices.
- The Bank of Canada meeting on Wednesday left CAD largely untouched, as the bank merely reiterated its lower-for-longer pledge while acknowledging global and domestic conditions have improved. In our BoC meeting review, we highlight how the BoC stance will not get on the way of more CAD appreciation, in our view. Next week, November CPI numbers will be watched closely to track any additional signs of life in inflation following October's surprising 0.7% YoY read. For now, however, tick-ups in inflation may not prove very beneficial for CAD considering that the BoC will hardly engage in tapering soon – even if inflation exceeds expectations. If anything, it might start to dent CAD's real rate attractiveness.

CHF: Thursday's SNB meeting the highlight

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0780	Neutral	1.0750 - 1.0840	1.0900

- As for many European pairs the outcome of Brexit will have a major say in EUR/CHF pricing this week. Failure to reach a deal could see EUR/CHF briefly dip below 1.0700, but we suspect the Swiss National Bank would step up FX intervention there – especially if markets were disorderly.
- Away from Brexit, the focus will be on the quarterly SNB meeting on Thursday. 3Q GDP growth was slightly stronger than expected, but with CPI running at -0.7% YoY, it is hard to see the SNB doing anything other than keeping the policy rate at -0.75% and threatening to intervene more against the highly valued Swiss Franc. If any kind of progress can be made on Brexit, the very positive developments in the European fiscal space should be a net positive for EUR/CHF – reducing risks of fragmentation and the political risk premium built into the EUR.

NOK: The NB should not deliver a Christmas surprise

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.6860	Neutral	10.5420 - 10.8000	10.7000

- Despite the plenty of good news over the past weeks and months, EUR/NOK has not broken below the 10.50 level. This is because 4Q tends to be the seasonally softest quarter for NOK (though it should reverse early next year, with January being seasonally the strongest month for NOK in the year) as well as its rather negative real rate. The latter is the reason why we don't expect EUR/NOK to return to the pre-pandemic levels of 10.00 next year – though we are bullish on NOK and target EUR/NOK 10.30 by the mid-year.
- On the domestic data front, the focus is on the Norges Bank meeting (Thursday). While the vaccine news improved the economic outlook for 2021, we expect the NB to keep the cautious tone in place and its mechanically driven interest rate forecast to remain largely unchanged. This in turn suggests a limited impact on NOK.

SEK: Calm week, with the krona driver by general risk appetite

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2670	Mildly Bearish ↘	10.1660 - 10.3310	10.2000

- It is a super quiet week on the Swedish data front, with the various measures of the unemployment rate to have a non-existent impact on SEK. Instead, and as was the case over the past months, the krona should be driven by the general risk appetite, with a muted reaction to the domestic drives (as was very much evident on the limited negative SEK response to the surprising top up of the Riskbank QE in the November meeting).
- We are constructive on the outlook for risk appetite for the next week, suggesting a limited downside to SEK with EUR/SEK potentially retesting the 10.20 level. However, we look for a more SEK upside and EUR/SEK testing the psychological level during 1H21 as the tough winter months will be closer to an end and the anticipated recovery in global trade pushes SEK higher.

Authors

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

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