G10 FX Week Ahead: Reading between the lines

Investors will focus on policy meeting minutes from the Fed and the ECB next week in search of hints that the first one has started discussing the timing of tapering and the second one is planning to thwart EUR strength. Meanwhile, progress on the US fiscal stimulus side may still offer support to risk assets and keep the dollar upside limited

Fed Chair, Jerome Powell

Source: Shutterstock

USD: FOMC minutes may be the highlight of a slow week

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.7240	Neutral	90.0000 - 91.0000	90.0000

- After a quiet start to the week given Monday's US public holiday and the China New Year, the focus will return to prospects of US stimulus and what the Fed is going to do about it. The stimulus plan will still be in the committee stage this coming week before going to a full vote week commencing 22 February. The plan's passage is seen as reasonably smooth, suggesting US equities remain supported on dips. In terms of the Fed reaction, Wednesday sees the release of the FOMC minutes. There is a slight risk of upset in the bond market should 'a few members' want to discuss the appropriate timing of the withdrawal of stimulus – though it does seem clear from Powell's remarks that it is far too early to be discussing this. On the data front, January retail sales and Industrial Production should come in on the strong side perhaps driving the dollar to its strongest levels of the week Wednesday into Thursday.
- The US retail investor frenzy should come back into focus as well. Thursday sees key participants in GameStop volatility testify to the House Financial Services Committee. It will be a case of those defending the democratization of finance running up against allegations of market abuse. More fuel for the fire could have been provided earlier in the week on Tuesday when hedge funds reveal 13F filings for positioning in 4Q20. These could provide fresh insights into large investor shorts and provide fodder for the Reddit community.

EUR: Minutes to reveal the ECB's plan to thwart EUR strength?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2088	Neutral	1.2050 - 1.2200	1.2200

- EUR/USD has been trading very narrow ranges over recent days and that may continue through the early part of week. Pressure may emerge around the release of the FOMC minutes, but perhaps 1.2050 might be enough of a correction. In terms of European inputs, the coming week will see Eurozone 4Q GDP (expected at -0.7% QoQ), minutes of the 21 January ECB meeting and the first look at the February PMIs for the region. On the minutes, the key focus will probably be the ECB's reaction to EUR strength and whether it would choose more QE or depo rate cuts to address it. With the market somewhat desensitised to this debate and already toying with pricing a depo rate cut over the next twelve months, we doubt that this discussion in the minutes would have much impact on the EUR or money markets – but it's certainly an event risk to brace for.
- As to the PMIs, consensus seems reasonably pessimistic – e.g. Eurozone composite PMI expected at 48.0. As yet there are no signs of a lift-off in the European vaccine roll-out. However, the situation could change over the next month and we are not big subscribers to the 'US exceptionalism' argument for a weaker EUR/USD.

JPY: More focus on the BoJ 18/19 March meeting

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	105.09	Mildly Bearish	104.50 - 105.50	102.00

- USD/JPY remains reasonably well bid, which may be partially down to the view: i) if the dollar is to rally anywhere on the back of higher US yields, it will be against JPY, ii) Japanese investors have been steady buyers of foreign bonds since the start of the year and iii) speculation is growing the Bank of Japan might open up more dovish settings (rate cuts) when it announces new monetary policy strategy on 18/19 March.
- We're still slightly negative on USD/JPY and the dollar in general. USD hedging costs for Japanese investors remain low (just 0.35% per annum using 3m forwards). US money market rates and USD hedging costs might even fall slightly further when the wall of money sitting in the US Treasury's General Account winds up as extra US bank reserves, once US stimulus checks go out.

GBP: Data unlikely to dent good momentum

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3804	Mildly Bullish	1.3750 - 1.3920	1.3800

- It is a busy week on the UK data front. Jan Inflation (Wednesday) should remain depressed by energy prices rising by on 1.3%. Jan retail sales (Friday) look set to plunge once more. Manufacturing PMI should decline but remain in the expansionary territory while Service PMI should remain firmly below 50. However, the forward looking value of PMI is rather low at this point. All in all, while a busy week data-wise, the impact on GBP should be limited. The data points don't reflect the vaccination associated positive prospects for a strong recovery in 2Q and should not also change the current neutral BoE stance.
- GBP/USD should be primarily driven by the direction of the risk sentiment next week, with the dollar rebound fading (with the cautious message from Chair Powell this week taking some upside for the dollar), the outlook for GBP/USD is neutral / modestly positive next week.

AUD: Jobs numbers to have reduced impact

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7722	Mildly Bullish	0.7680 - 0.7820	0.7600

- We have published an update on our AUD view this week ("AUD: In balance between doves and iron ore"): we see AUD as the most vulnerable currency in the G10 $-bloc due to its ever more unattractive rate profile after the RBA dovish shift and the material risks of iron ore price corrections. We remain bullish on AUD/USD in the medium-term as we think the global reflation story and a generalized weak-USD environment should ultimately prevail and push the pair above 0.80 in 2H21.
- Looking at the coming days, the ability of AUD to recover further will be challenged by the worsening contagion situation in Australia. The number of cases is very low compared to Europe or the US, but Australian authorities have been very quick to respond to new outbreaks with strict containment measures. Victoria announced a 5-day circuit-breaker lockdown today as multiple people linked with one hotel tested positive for the more contagious virus variant originally found in the UK. Any extension of the lockdown in Victoria will likely weigh on AUD. Data-wise, the highlight of the week is the January jobs report. We suspect the impact on AUD will be more contained than in previous instances as data look unlikely to move rate expectations considering the Reserve Bank of Australia recently announced fresh easing measures and better data didn't really prompt any optimistic turn in the latest policy message. The RBA minutes released next week will provide more details on the policy direction following the strong dovish turn. Elsewhere, iron ore will remain a key market to watch for AUD: investors have likely frontloaded higher Chinese demand after the Lunar Year holiday and any disappointment in shipments figures may trigger a new correction in prices.

NZD: Looking beyond the long-squeeze

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7177	Mildly Bullish	0.7150 - 0.7260	0.7200

- NZD has lost some of the ground it had gained versus the AUD as the latter rebounded on fresh iron ore strength. NZD is lacking a clear catalyst at the moment given there are no domestic events likely to move the market before the 24 February Reserve Bank of New Zealand meeting. The recent NZD underperformance may have been largely the result of some long squeezing effect on the currency: CFTC data had already shown some material position squaring among speculative investors in the week ending 2 February. The effect of this technical factor on NZD may start to wear off in the coming days.
- The set of drivers continue to indicate – in our view – that the balance of risks for AUD/NZD is tilted to the downside in the next weeks. The reasons are that: a) we don't expect the RBNZ to come close to the RBA dovishness at its 24 February meeting, b) AUD is facing the risk of more iron ore price corrections, c) some parts of Australia are entering lockdown while NZ remains a nearly virus-free (and restriction-free) country. We expect the global risk sentiment to remain supported next week, so NZD should also gain vs the safe-haven USD.

CAD: Inflation not raising too many questions for now

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2755	Mildly Bearish	1.2630 - 1.2800	1.2700

- CAD has had a strong week as it recovered from the very grim jobs numbers for January released on 5 February. This coming week, data should come back into focus as January CPI data are released. Inflation have likely received some support from higher gasoline prices but the soft activity numbers suggest a lack of pricing power which should ultimately keep core inflation subdued.
- Barring any major deviations from the latest levels, inflation is set to stay well below the Bank of Canada's 2% target, which would continue to put off the question of whether the bank will tolerate higher inflation (like the Fed) without tightening monetary policy. Looking at external factors, the progress on the US fiscal stimulus front should continue to have a positive effect on CAD both through the risk sentiment and the economic sentiment channel (due to Canada's dependency to US demand). A consolidation of WTI above US$58/bbl could keep the upside on USD/CAD contained: we could see the pair move back into the 1.26 region.

CHF: Welcome developments in Italy

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0801	Mildly Bullish	1.0780 - 1.0860	1.0900

- We are a little disappointed that EUR/CHF has not followed Italian bonds higher on expectations that Mario Draghi will be able to form a new government in Italy without early elections. Our bond team sees the BTP: Bund spread dropping to 75bp this year from 90bp currently. That should prove a supportive backdrop for EUR/CHF and perhaps deliver a test of the 1.0850/60 area over the coming week.
- The Swiss data calendar typically has little bearing on EUR/CHF, although a slightly better-than-expected January CPI figure (including core YoY exiting deflation for the first time since last March) suggests the Swiss National Bank's battle against deflation might be slightly easier. We will also be watching to see if USD/CHF stays below 0.8950/70 this week – to keep the dollar tone broadly offered. USD/CHF has been providing clues on the broader dollar trend recently.

NOK: External factors remain supportive

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.2900	Neutral	10.2100 - 10.3500	10.2500

- The rising equity markets, cautious Fed Chair Powell and rising oil priced all translated into further NOK gains. But with oil prices already above US$60/bbl and NOK already rebound meaningfully from the its late Jan lows, the 10.20 level, which so far acted as a strong support level, should hold. We remain upbeat on NOK prospects for 2021, expect EUR/NOK to drop below 10.00 level this year but more pronounced gains are likely only one we see the post winter rebound in global (and particularly European) economy
- It is a very quiet week on the Norwegian data front. The only data point of note is the January trade balance but this will not affect NOK at all.

SEK: Inflation to have limited rate implications

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.0800	Neutral	10.0400 - 10.1400	10.1000

- The EUR/SEK 10.00 level remain a strong gravity line for the cross and the same trend is set to continue next week. The Jan CPIF inflation is likely to show a strong rebound to 1.7%, and while on the day it may lead to strong SEK, the krona upside should be short lived (i.e. EUR/SEK staying above the 10.00 level) as it is unlikely to affect the Riksbank's stance.
- Indeed, Riksbank inflation report this week showed at (a) the bank is aware of the volatile profile of CPI and the upside inflation pressures in early in the year (b) as CPI is will remain below 2% target over the forest horizon, any reaction from Risksbank is highly unlikely. Indeed the flat interest profile published this week showed a clear message. Hence, we expect more of the same and EUR/SEK should remain tied to tits recent ranges.

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