G10 FX Week Ahead: Springing forward with the Fed

In a week in which the clocks go forward in North America, FX markets will be focusing on the FOMC meeting on Wednesday. It looks too early for a significant change in the Fed's dovish tone. Risks assets could strengthen and USD weaken once this risk event passes. Elsewhere, the BoJ policy review will be in focus, while the BoE should not surprise markets

USD: Bracing for the Fed

	Spot	Week ahead bias	Range next week	1 month target
DXY	91.8170	Mildly Bullish	91.2000 - 92.2000	91.0000

- The highlight of the week ahead will be Wednesday's Fed meeting. We'll get to see a new set of quarterly projections, where 2021 GDP will likely be revised higher from the 4.2% median in December. There will also be a lot of interest in the Fed Funds rate Dot Plots. Does the Fed 2023 Dot Plot median shift to a 25bp hike? Probably not, but the dollar would probably rally if it did. Yet a largely unchanged FOMC statement and a Jay Powell press conference repeating that the Fed has a long way to go before reducing stimulus should prevent the dollar running too far ahead. That said, it is hard to see the Fed Chairman altering his laissez-faire comments about the US Treasuries made to the WSJ just a couple of weeks ago. And on the subject of Treasuries there is huge focus on whether the Fed extends its US Treasury exemption from the Supplementary Leverage Ratio – due to expire at the end of the month. Failing to extend it would be a big surprise, hit Treasuries and also hit equities on the view that US banks would have to raise more equity capital.
- Away from the Fed, US data released over the next week should be a little less impressive. February retail sales should correct lower from the stimulus-inspired January surge. And poor weather will have impacted February industrial production. Also look out US-China political developments, where senior officials meet in Alaska on Thursday ahead of an annual US report to Congress on Friday detailing security implications of the US economic relationship with China. Also remember that US clocks spring forward early Sunday, briefly narrowing the time difference with Europe.

EUR: Waiting for lift off

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1925	Neutral	1.1835 - 1.2050	1.2200

EUR/USD has held good support near the 200-day moving average at 1.1830 and the big question is: was that the correction? With US Treasury yields still near 1.60% and a big Fed event risk to come next Wednesday, it is probably too soon to declare that EUR/USD is ready to resume its rally. Covid challenges in continental Europe aren't helping the EUR either, where rising case numbers, slow vaccine roll-outs and doubts about the AstraZeneca vaccine are all delaying recovery hopes.

It is a quiet weak for European data after the recent ECB fireworks. And the ECB have said their front-loaded PEPP buying will not register in the weekly reports until Monday, 22 March. However, we do not think more aggressive PEPP will have much impact on the EUR. Also look out for German regional elections on Sunday. A heavy defeat for Merkel's CDU party could briefly upset the EUR in Asia on early Monday. Please see a full German election preview here.

JPY: BoJ policy review is the highlight

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.06	Mildly Bullish	108.30 - 109.80	107.00

- USD/JPY continues to creep higher and it is not clear what can reverse this short term trend. The highlight in the week ahead will be the BoJ's policy review announced on Friday. The reason for the policy review was to examine how its policies (in a downturn) could be more sustainable. Thus, it would seem unlikely that the BoJ meeting ends up tightening Japanese financial conditions. In the frame are issues like a) can room be created for even more negative rates by protecting banks even more from charges on excess reserves held at the BoJ and b) examining more flexibility in its JGB buying or stock ETF buying operations. The BoJ will be only too aware that loosening up the +/- 20bp target around 0% 10-year JGB yields could trigger a JGB sell-off in the current global bear market for bonds.
- With upside risks to US Treasury yields still present, and USD/JPY showing the tightest positive correlation to those yields, we see upside risks to 109.80 in USD/JPY this week. But with 3m USD/JPY hedging costs still a very low 0.35% per annum through the 3m forward, we are still a little surprised at the above correlation. Indeed, when surveys of Japanese life insurers are released over coming weeks, we would expect greater allocation weights made to hedged foreign bond portfolios and a reduction in the unhedged foreign bond portfolio weightings.

GBP: The BoE stick to the cautious optimist outlook

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3886	Mildly Bullish	1.3785 - 1.4070	1.4400

The BoE (Thursday) should keep its constructive outlook in place, with the fast pace of vaccination (and the pace is poised to double from the next week onwards) supporting the optimistic outlook for the economic recovery. Unlike the ECB this week, we don't expect the BoE lean against the rising bond yields next week. But with the market already pricing a close to one hike for 2022 and another one for 2023, the cautiously upbeat BoE message next week might be a modest positive for GBP, yet not a catalyst for some profound GBP gains.

With EUR/USD poised to stabilize as US Treasuries are showing signs of a less erratic behaviour, this should largely cap the recent GBP/USD decline. GBP/USD to grind back towards 1.40 next week. We expect GBP/USD to rebound strongly from 2Q onwards, in line with the expected EUR/USD gains. Beyond the BoE meeting, it is a very quiet week on the UK data front. The February Public sector net borrowing date (Friday) shouldn't have much of an impact on GBP.

AUD: Beware the correction in iron ore

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7741	Neutral	0.7660 - 0.7800	0.7700

- AUD took advantage of a recovery/stabilization in local bonds and the generalized supported risk sentiment to consolidate above the 0.77 level. The Reserve Bank of Australia's interventions in the bond market have eased thanks to weakening global selling pressure on bonds, but the Bank likely stands ready to step in with more big purchases to counter any future spikes in yields. We may have confirmation of this in the minutes from the March RBA meeting published next week, which may shed some light on the RBA members' views on the recent bond sell-off and the measures to control bond volatility. Signs of lingering commitment to defend the yield target and keep yields capped may provide some mild support to AUD next week. On the data side, jobs numbers for January should give some encouraging signs, but the impact on RBA expectations (and AUD) should be limited.
- Iron ore prices have faced a correction this week after the Chinese steel-producing city of Tangshan imposed restrictions on steel production to reduce polluting emissions. With Chinese demand having been the key driver of higher iron ore prices over the past year, concerns about any slowdown in this sense should continue to have a magnified effect on iron ore prices. We continue to deem the current levels of iron ore prices as unsustainable, and the material risk of a bigger correction is a major threat to AUD short-term ability to remain supported.

NZD: Data to confirm economic resilience

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7164	Neutral	0.7115 - 0.7250	0.7300

- NZD has struggled to cash in on good risk sentiment, possibly held back by the economic impact of the Auckland lockdown (restrictions were lifted today) and some additional long-squeezing (NZD is materially overbought, according to CFTC positioning data).
- Next week, the focus will be on 4Q GDP numbers that are expected to come at 0.5% YoY and should therefore confirm the better performance of the NZ economy in 2020 compared to the rest of developed nations. The release may provide a floor below NZD next week but the dynamics in US Treasury yields (the Fed meeting will be pivotal) should remain firmly in the driving seat for NZD/USD.

CAD: BoC tapering speculation may rise

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2524	Neutral	1.2450 - 1.2600	1.2500

- A set of very strong jobs data today considerably downsized concerns about a slowing recovery in the Canadian economy. Employment rose by 259k in February, basically erasing the losses of December and January, and the unemployment rate dropped to 8.2%. This is quite relevant in perspective for the Bank of Canada, that unsurprisingly held their policy message unchanged this week, but may feel the pressure to deliver more tapering at 21 April meeting, when new economic projections will also be released.
- Another important piece of information for the BoC will be added next week with the release of February's CPI figures. Signs of materially rising inflation may see investors starting to doubt the BoC 2023 forward guidance, and possibly add some pressure to Canadian front-end rates. All this may help the Canadian dollar weather some fresh USD strength (see USD section above) better than AUD and NZD.

CHF: Poised to weaken further

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1105	Mildly Bearish ↘	1.1050 - 1.1150	1.1200

- EUR/CHF remains relatively bid, despite the recent sell-off in risk assets – particularly in emerging markets. Notably, however, European equities have stayed bid and supreme confidence in the 2H recovery should keep EUR/CHF supported on dips. Remember that we think there are still a lot of precautionary long CHF positions out there that have yet to be unwound.
- There's really not a lot of Swiss data in the coming week, but one can argue that the ECB containing European bond yields with front-loaded PEPP is good for European growth/risk and hence good for EUR/CHF. The downside is the troubling re-appearance of Covid cases and consequent lockdowns. Let's hope the latter comes under control shortly.

SEK: the worst for SEK seems to be over

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1400	Mildly Bearish ↘	10.0400 - 10.2000	10.1000

- Swedish Feb CPI (Monday) is set to accelerate further, yet the Riskbank should (like the ECB) to look through the rising inflation over the coming months as the rise in prices should be only temporary. In the sharp contrast to the NB, the Riskbank will stick the neutral / modestly dovish bias for a pro-longed period of time , making rate hikes this year and next a very low probability event. As a result, we expect further uptrend in NOK/SEK.
- As for EUR/SEK, the worst for the krona seems to be over and the pair should return to the very gradual downtrend, to / below 10.00 by the end of the next quarter. As for the next week, as long as the global risk sentiment continues stabilising, EUR/SEK should grind towards the its 10.1000 gravity line of past months.

NOK: The NB pushing NOK further up

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.0900	Bearish ↘	9.9000 - 10.2000	10.2000

- The possible hawkish bias of the Norges Bank (NB) meeting next Thursday is likely to be another tailwind for NOK. Rising CPI, higher oil prices and optimistic prospects for the vaccination suggest further upward revision to the interest rate path – both in terms of bringing the timing of the first rate hike forward and raise the interest path across the forecast horizon. The upgrade to the interest rate path is likely to push EUR/NOK lower, with the psychological EUR/NOK 10.00 level likely to be seriously tested next week.
- With the pace of the UST sell-off slowing, the subsequently more stable risk environment is a positive for high beta, low liquid NOK. While NOK predominantly benefited from higher oil prices over the past weeks, next week the NB should offer additional helping hand.

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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