G10 FX Week Ahead: Hard as iron

A potential extension of the China-led sell-off in iron ore prices next week will be at the centre of market focus, with AUD facing the largest downside risk in G10. In the US, the FOMC minutes should have a limited impact and with higher CPI numbers largely processed by the market now, the dollar may start to re-join its benign bear-trend.

USD: FOMC minutes shouldn't do too much damage

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.4400	Mildly Bearish	90.0000 - 91.0000	90.0000

- 2Q21 was always going to be a tricky period for asset markets, where inflation was set to spike and the Fed's dovish policy would come into question. So far markets have coped reasonably well with April US inflation pushing above 4% and DXY, surprisingly to some, is barely 1% above the lows of the year. On paper, the week ahead should not interfere with this benign trend. The US data calendar is light, just April housing starts and new home sales. And the highlight will probably be Wednesday's release of the FOMC minutes from the April 28th meeting. Perhaps the key takeaway from Powell's press conference that day were the words 'now is not the time to talk tapering'. With that in mind, we expect the markets to absorb in their stride any suggestions that a 'few participants' were a little less dovish.
- The week ahead will also see China release April retail sales and industrial production. Markets will also be watching whether any Chinese official concern over commodity increases has any follow-through selling in that complex. Investors should also keep an eye on US Big Tech shares. These have been suffering at the hands of higher inflation. It could be a better week for this sector given the US price story should be quieter. Yet a sharp correction lower here looks to be one of the biggest threats to an otherwise benign, and slightly $ bearish, outlook.

EUR: So far, so good

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2119	Mildly Bullish	1.2050 - 1.2200	1.2200

- EUR/USD has weathered the first batch of strong US data relatively well. Keeping EUR/USD supported is: i) the Fed committed to looking through the inflation spike and keeping US real rates very negative and ii) confidence growing in the Eurozone recovery and investors starting to ask questions of the ECB whether EUR real rates are right to be as equally negative. In other words, will the ECB have less tolerance of higher inflation than the Fed? Contributing to that debate in the week ahead will be a variety of speeches from ECB big-hitters, such as Lagarde and Lane. We'll also see the first revision to 1Q EZ GDP (seen at -0.6% QoQ). More important will be first look at the flash PMIs for May (Friday) – expected to stay strong as economies start to re-open after third wave lockdowns.
- German elections may drift back onto the market's radar this week when candidates to replace Angela Merkel debate on Thursday. Latest opinion polls show the Greens still with a slight lead over the CDU/CSU, making the case for greater Green representation in any new coalition government. Green policies of slightly looser fiscal settings and greater European integration are seen as positive for the EUR.

JPY: Brace position

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.33	Neutral	108.50 - 110.00	108.00

- USD/JPY once again was one of the pairs to be impacted the most by the US CPI print. Most, understandably, are convinced that US rates are too low at this stage in the cycle and that it is only a matter of time before US 10-year yields push towards the 1.90/2.00% area. Thus, expectations are building that USD/JPY will exit a 108-111 range to the upside. This view does require a jump in US real rates, however, and so far there has been little sign of the Fed preparing to play ball by offering a less dovish setting. That's why we're not as bullish as some on USD/JPY.
- Away from the US calendar, we'll get our first look at 1Q21 Japanese GDP this week. This is expected at -1.2% QoQ. The BoJ has actually been revising up its growth estimates recently, so GDP data should provide some insights on whether they were right to do so. We'll also see the April trade balance this week and April CPI, expected still at -0.2% YoY on the core measure. We are also hearing a little more about investors wanting to rotate into Japanese equities – especially after the recent dip. Let's see how resilient that foreign interest is when the weekly MoF portfolio transaction data is released on Thursday.

GBP: Solid UK data to help sterling next week

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.4079	Mildly Bullish	1.3970 - 1.4200	1.4400

- The cable decisively broke above 1.4000 and even the material upside surprise to the US April CPI was not enough to bring the cross below this psychological level. We see the impact of the recent US CPI spike on GBP/USD as a one-off and temporary and look for a further trend higher. Domestically, although the spread of the India Covid variant is rising concerns, this has so far been linked only to specific regions. Importantly, the vaccines seem to be working against this variant. As a result, the general reopening story should therefore go ahead and the improving UK economic data should continue supporting GBP.
- The UK data points next week should be positive and help GBP. On Tuesday, we look for another decline in the unemployment rate. April CPI (Wed) should edge higher to 1.5% YoY and is to exceed 2% later in the year. On Friday, April retail sales should rise (linked to the reopening of shops in April) and May PMIs should be encouraging as the economic outlook is improving.

AUD: Watch the iron ore slump!

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7755	Mildly Bearish	0.7650 - 0.7800	0.7800

- A so-far very supporting factor for AUD has rapidly turned into a negative one: iron ore prices experienced a fierce sell-off late this week after China took steps to control the surge in commodity prices. On Friday, Tangshan city banned steelmakers from fabricating or spreading price-hike information. We have long highlighted how the levels of iron ore prices looked unsustainable of late: a resilience in Chinese demand inflated them, now any signs that demand could shrink are set to cause sharp drop in prices.
- Iron ore is the market to watch for AUD next week, although the April jobs report in Australia will also be in focus. The recovery in employment should have continued in April, although likely at a lighter pace. Any market impact of the release may be relatively contained considering any hawkish turn by the Reserve Bank of Australia is unlikely to be imminent considering weak inflation. The minutes of May's RBA meeting should reiterate how low inflation continues to make a case for "lower-for-longer".

NZD: A very quiet week

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7225	Mildly Bullish	0.7170 - 0.7330	0.7400

- Unlike AUD, the Kiwi dollar doesn't have to face the impact of a drop in its main export commodity price and should therefore be facing less downside risk next week.
- It is going to be a very quiet period in New Zealand data-wise as we head into the 26 May Reserve Bank of New Zealand meeting, with the bank starting to feel the pressure to sound less dovish considering the better-than-expected recovery in the jobs market, inflation not far from target and – although this may not be explicitly mentioned – house prices still struggling to trend lower despite the government's measures.

CAD: Inflation surprise can fuel tapering expectations further

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2125	Mildly Bearish	1.2000 - 1.2160	1.2000

- CAD has remained more protected from the swings in risk sentiment this week, signalling how the bullish momentum on the loonie has not entirely faded yet. We discuss the outlook, and our new forecast profile for CAD, in "CAD: Hard to buck the bullish trend". In addition to the supportive influence of a less dovish Bank of Canada, we expect the improvements on the vaccination side in Canada to make markets less reactive to bad data for those months affected by Covid-19 restrictions.
- The key event next week is the inflation report for the month of April. Following the big jump in CPI in the US last week, markets are likely positioned for a relatively strong read also in Canada, although containment measures likely prevented a similar jump in prices. The key difference between the US and Canada, however, is that the BoC has proven to be reactive to improving domestic fundamentals, which suggests that a jump in inflation may prompt markets to price in an even faster unwinding of the BoC asset purchases this year. USD/CAD may start to approach the 1.2000 level.

CHF: Is ECB tapering playing a role here?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0953	Mildly Bullish	1.0930 - 1.1030	1.1100

- EUR/CHF continues to trade on the soft side – even after what seemed to be quite a benign ruling on the Polish FX mortgage saga. Casting around for factors that could be depressing EUR/CHF, we note the recent rise in BTP:Bund spreads. The 10 year spread is gaining a little momentum to the upside (+20bp over the month), largely on the view that the ECB will reduce its aggressive PEPP buying scheme. Recall this scheme has primarily been buying government bonds and Italy had been a big beneficiary here. Wider BTP:Bund spreads can occasionally depress EUR/CHF. Further speculation over this PEPP slowdown could cause some more problems for EUR/CHF.
- Overall, however, we prefer EUR/CHF to trade back to 1.11 over coming weeks as confidence grows in the global recovery and EUR/USD stays supported. As a core view, we expect the Swiss National Bank to position itself substantially behind the ECB when it comes to policy normalisation – a key factor that should drive EUR/CHF higher multi-quarter.

NOK: Wider inflation pressure make NB more likely to act

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.0100	Mildly Bearish ↘	9.9500 - 10.1570	9.9500

- The negative impact of the strong US April CPI on NOK was temporary and EUR/NOK is now back close to the 10.00 level. With the upside risks to inflation reading being a global phenomenon, NOK should be one of the main beneficiaries as the Norges Bank is the G10 central bank that is likely to react first on the interest rate side. While the late 4Q21 hike is already well flagged by the NB, an earlier hike in September is also on cards. This is a clear supportive factor for NOK. Brent oil testing the US$70/bbl level is also helpful for the krone.
- It is a fairly calm week on the Norwegian data front. We only have the April Trade balance (Tuesday) and this won't affect NOK price action too much.

SEK: Hovering around the EUR/SEK 10.10 gravity line is the name of the game

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1200	Neutral	10.0400 - 10.1930	10.1000

- It continues to be the more of the same for SEK, with the EUR/SEK 10.10 gravity line being the level to which SEK continues to converge, irrespective of upside or downside surprises to global risk appetite or domestic data. This was the case in the past week and should be the case next week. While next week the EUR/SEK 10.10 level should be the target, we look for more krona gains as we get into the summer with SEK set to benefit from the more synchronized global recovery (as Europe in part catches up with the US).
- There is not much to see on the domestic data front next week. 1Q industrial capacity (Friday) should have no impact on SEK. The bar is high for domestic data to impact SEK meaningfully given there is no spill over into the Riskbank reaction function as the central bank has been clear it will keep the key rate unchanged this year and next. Indeed, the rise in the April CPI above 2% this week had no impact on SEK as the central bank signalled it would look through it.

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