

## G10 FX Week Ahead: We haven't seen the dollar peak yet

A consolidation of Fed tightening expectations at the start of the year oddly coincided with an unwinding of dollar longs. We think that a more balanced positioning can help USD recover and a move above 1.1500 in EUR/USD seems unwarranted. Elsewhere, GBP should remain immune to political noise and a Norges Bank hold should not tamper with more NOK gains



Source: Shutterstock

## USD: Softness not there to last

|     | Spot    | Week ahead bias  | Range next week   | 1 month target |
|-----|---------|--|-------------------|----------------|
| DXY | 95.0000 | Mildly Bullish  | 94.6000 - 95.6000 | 96.0000        |

- A start of the year that saw a consolidation of the view that the Fed will hike three times – while leaving room to speculate on a fourth one – coincided with a quite surprising weakening of the dollar across the board. We think this was mostly due to a sell-the-fact attitude – it is not uncommon this happens around NFP or CPI releases – which triggered a sizeable unwinding of dollar net longs, as well as overseas markets becoming more attractive. We doubt this was due to a real re-rating of the US growth story.
- The dollar can now count on a more balanced positioning, which is leaving room to re-build some long positions on the greenback in the run-in to the start of the Fed tightening – historically a period of dollar strength. Soft 4Q growth data from China may provide some support to the dollar next week, while the US data calendar includes the University of Michigan sentiment indicator, the Empire Manufacturing index and a bunch of housing data. All in all, we expect a stabilisation or some recovery in the dollar in the week ahead.

## EUR: Not looking on a move above 1.1500

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/USD | 1.1424 | Neutral         | 1.1350 - 1.1480 | 1.1200         |

- The week ahead bears an important question for FX markets: will EUR/USD break above 1.1500? As discussed in the section above, we do not trust the current USD softness, and we are thus inclined to think that EUR/USD is due for a correction rather than another leg higher. Incidentally, there is still quite a lot not to like about the EUR: a) the Omicron-induced growth re-rating, which is offering a reason for the ECB to stay cautious on policy normalisation, b) the eurozone being on the wrong side of the high energy price story, and c) the EUR can suffer from Geopolitical tension in Russia and political noise in Italy (more in the CHF section).
- Most of the focus in the week ahead will be on the ECB minutes from the December meeting: a chance to gauge the strength of the hawkish bloc in the policy discussion. Still, any hawkish headline should be filtered by the fact that the Omicron situation in Europe was not as bad when the meeting took place compared to the following weeks. We expect EUR/USD to slide back to 1.12/1.13 in the near term, but for next week, we'd already welcome a stabilisation below 1.1500 as a sign that the bullish push on the pair was temporary.

## JPY: BoJ meeting another non-event

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| USD/JPY | 113.83 | Mildly Bullish  | 113.30 - 115.00 | 116.00         |

- In an environment where markets extensively unwound long dollar positions, a very oversold currency like the yen is finding good support. Most importantly, however, the soft dollar momentum is making the JPY emerge as the primary safe-haven as equity markets continue to show vulnerability.
- The performance of risk assets is set to remain key for the yen in the week ahead, although our rates team expects 10y Treasuries to come under pressure again, which should put a cap on JPY gains. Domestically, all eyes will be on the Bank of Japan policy meeting. Like in recent instances, we expect the meeting to be a non-event for JPY: the BoJ should unsurprisingly revise its growth forecasts lower, and its inflation forecasts higher, while signalling no changes in the policy mix. We think USD/JPY can climb back into the 114/115 area next week.

## GBP: Still untouched by political noise

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| GBP/USD | 1.3681 | Neutral         | 1.3600 - 1.3760 | 1.3500         |

- UK [GDP figures](#) released on Friday beat expectations and suggested the Omicron impact on growth may ultimately prove modest. Ultimately, this should keep the quite aggressive hawkish expectations on BoE tightening alive. We think next week's data releases will keep offering support to the pound. Jobs numbers should be strong, wage growth should stabilise around pre-pandemic levels and inflation should continue to edge higher. All this should offset some weaker retail sales on Friday. We expect GBP strength to emerge mostly against the EUR next week, and we still expect EUR/GBP to move below 0.83 in the near term.
- A testament of the pound's good momentum in the new year has indeed been the non-reactiveness of the currency to the political events in the UK. Prime Minister Boris Johnson is facing calls – also from within the Conservative party – to resign after he admitted he participated at a gathering in Downing Street in May 2020, when strict containment rules were in place. 54 Tory MPs would be required to trigger a confidence vote, although many have signalled they will wait before an official probe on the matter is concluded. Still, the risk of a change of Prime Minister is rising dramatically, with Chancellor Rishi Sunak and Foreign Secretary Liz Truss now looking like the front runners. We think that a resignation by Boris may have a quite limited negative impact on GBP, as there would be no immediate implications for the UK growth outlook. Most focus should be on the Brexit stance: Truss' first meeting with EU officials seemed to indicate some a less confrontational approach, although the discussions over the Northern Ireland protocol are still set to prove challenging.

## AUD: Assessing the antipodeans' underperformance

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| AUD/USD | 0.7238 | Mildly Bearish  | 0.7190 - 0.7260 | 0.7200         |

- While all G10 currencies have strengthened against the dollar in the new year, the Aussie dollar is trading around 0.3% weaker. That is mostly due to Friday's drop in equities which has triggered a correction in AUD/USD after a good week. Still, the fact that NZD is only flat in the year vs the USD is indicating that antipodeans are clearly bearing the brunt of sentiment instability while not fully benefiting from USD weakness.
- We think the two key reasons behind this dynamic are the exposure to China's zero – Covid policy – and next week's growth data potential falling below 4% should increase the negative spill-over – but also the lack of positive exposure to rallying oil prices (here, markets prefer to play risk-on bets through CAD and NOK). Domestic data may not offer much help next week as hiring in Australia should have cooled off in December after November's very strong numbers. The unemployment rate may still edge lower (4.5%), but with a lot of Reserve Bank of Australia tightening already in the price, we see little room for more hawkish re-pricing. AUD/USD may edge back below 0.7200.

## NZD: China risk dominates

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| NZD/USD | 0.7160 | Mildly Bearish  | 0.6750 - 0.6850 | 0.6800         |

- Most of considerations made for AUD can apply to NZD, as we see no clear catalyst for a divergence between the two currencies in the week ahead. NZD/USD could fall back below 0.6800.
- Like for the RBA, Reserve Bank of New Zealand rate expectations are quite stretched, although we still expect 125bp (vs 150bp priced in) of tightening in 2022. Along with the spill-over from soft Chinese data, we see some risks that lockdown-impacted 4Q jobs figures in New Zealand (to be released 1 February) can trigger some re-pricing of rate expectations and weigh on NZD. Still, NZD should remain more attractive than AUD in 1H22 thanks to monetary policy divergence.

## CAD: Inflation to keep endorsing tightening expectations

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/CAD | 1.2330 | Neutral         | 1.2450 - 1.2600 | 1.2500         |

- The very good performance of oil at the start of the year has propelled CAD among others. This week, USD/CAD missed a chance to decisively break below 1.2500, with Friday's sentiment jitters coming to the support of the pair.
- The Covid situation in Canada is quite serious and strict containment measures are inevitably weighing on the growth outlook. They are not, however, weighing on the market's tightening expectations for the Bank of Canada, which have remained broadly intact. We think this is based on the notion that the Canadian economy (and especially the jobs market) was in a very good place before Omicron hit, and the new lockdowns may not derail the BoC plans. This notion might be challenged by the BoC at the 26 January meeting, but for now eyes will be on the CPI figures for December, which are expected to show another slight increase in headline inflation, which could give some support to CAD. Also, keep an eye on the BoC Business Outlook for 4Q: the previous editions showed record figures for CAPEX investments. Also, keep an eye on the BoC Business Outlook for 4Q: the previous editions showed record figures for CAPEX investments. Barring a correction in oil prices, we think USD/CAD can linger around (or slightly above) 1.2500 in the next few days.

## CHF: Keep an eye on Italian politics

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/CHF | 1.0422 | Neutral         | 1.0370 - 1.0460 | 1.0400         |

- EUR/CHF has been on a rollercoaster ride so far in January. An widespread sell-off in CHF sent it to 1.0500 at the start of this week, only to see that level working as a strong resistance and sending the pair back into the 1.0400/1.0450 range at the time of writing.
- We flagged earlier this week how the sell-off in CHF appeared overstretched given the fragile environment for risk sentiment, and now we think we could see some flattening in the pair after all the recent action. There is, at the same time, one theme to keep an eye on: Italian politics, to which EUR/CHF has a high sensitivity. The parliament will vote to elect the new President of the Republic at the end of the month, and the current Prime Minister, Mario Draghi, appears to be a main candidate and may therefore leave his current role and open questions about the future of his reform plan. Former PM Silvio Berlusconi is another candidate, and he is threatening to pull the plug on the current coalition if he fails to secure the nomination. Any negative spill-overs onto the Italian bond market should mostly be channelled into a weaker EUR/CHF.

## NOK: Norges Bank to hold

|         | Spot   | Week ahead bias  | Range next week  | 1 month target |
|---------|--------|--|------------------|----------------|
| EUR/NOK | 9.9800 | Mildly Bearish  | 9.9000 - 10.0300 | 9.8500         |

- The Norges Bank meeting is the key event in the week ahead in Norway. Despite higher-than-expected inflation (5.3%) in December, and oil prices having significantly recovered, we think that the uncertainty generated by Omicron in Europe should convince policymakers to hold rates at this meeting. We expect to see a short statement, in which the Bank indicates that rates will likely be raised again in March.
- A hold should not come as a major surprise and while potentially generating some modest downside reaction in NOK, we think that the very supportive oil story can keep the krone attractive. We expect EUR/NOK to keep grinding lower in 1Q22, and next week we could see a move back towards the 9.90 mark.

## SEK: All quiet

|         | Spot    | Week ahead bias | Range next week   | 1 month target |
|---------|---------|-----------------|-------------------|----------------|
| EUR/SEK | 10.2700 | Neutral         | 10.2400 - 10.3200 | 10.2500        |

- Swedish inflation continued to accelerate in December, with CPIF rising to 4.1% (slightly above consensus). This is however proving insufficient to force a break lower in EUR/SEK, with the krona that continues to discount the unstable risk sentiment and the eurozone growth re-rating.
- The week ahead is very quiet data-wise, and we expect EUR/SEK to keep trading slightly below the 10.30 mark.

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