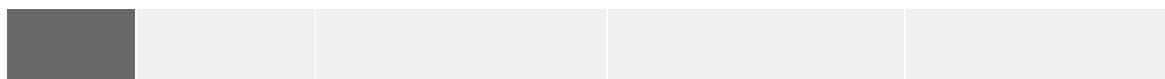


G10 FX Week Ahead: Chain reaction

FX markets will continue to be dominated by supply shocks in the commodity sector and how policymakers and businesses react. China's 3Q GDP will set the tone in the early part of the week, while October European PMIs will shed light on how businesses are coping. The BoE's response to high inflation won't stray far from the headlines either



USD: Looking for leadership

| | Spot | Week ahead bias | Range next week | 1 month target |
|-----|---------|-----------------|-------------------|----------------|
| DXY | 94.0000 | Neutral | 93.5000 - 94.5000 | 95.0000 |

- The recent broad-based dollar rally seems to have stalled and requires a fresh catalyst. Such a catalyst is not clear in the week ahead and suggests some further range trading may be due. In terms of the local calendar, the data is second tier (US industrial production, housing data) and a few Fed speakers. We will also see the release of the Fed's Beige Book ahead of the 3 November FOMC meeting.
- Broader FX trends, including for the dollar, may be set by events in emerging markets. The week starts with China releasing 3Q GDP data, where consensus expects a slowdown to 5% YoY from 7.9% YoY. Such an outcome would normally be seen as a negative for the commodity complex and bullish for the dollar – yet commodities continued to be buoyed by supply not demand trends and continue to add to near term inflationary risks. The week will also see some big rate meetings in the likes of Hungary, Turkey and Russia. The Turkish Lira could come under further pressure if the CBT delivered another surprise rate cut. In contrast, the Rouble remains in strong demand on the energy story and with the CBR set to improve RUB yields even further.

EUR: PMIs to start show the impact of the gas crisis?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|------------------|-----------------|----------------|
| EUR/USD | 1.1590 | Mildly Bearish ▼ | 1.1550 - 1.1650 | 1.1500 |

- EUR/USD has shown no interest in wanting to break big support at 1.1500 and a further period of consolidation looks likely. The top of the range should be the 1.1650/70 area. Even if the recovery in equities has legs – and supports the risk environment in general – we doubt EUR/USD needs to trade too much higher. Implied EUR yields via the 3m forwards are now -0.7% and makes the EUR a preferred funding currency.
- On the data front, the highlight of the week will be the flash October PMIs. Confidence in the manufacturing sector has been softening a little, but we could get to see the first impact of the gas crisis that is hitting the European industrial base. We will also see October consumer confidence for the Euro area. So far ECB heavy-hitters are not budging in their view that the ECB should not over-react to a temporary spike in prices. We have quite a few ECB speakers over the coming week, but not until the likes of Lagarde or Lane change their tune will there be a re-rating of the EUR. In fact, our rates team feel that the ECB cycle is already over-priced (10bp ECB rate hike priced for late 2022) while the Fed cycle is under-priced.

JPY: How large a September trade deficit?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| USD/JPY | 114.30 | Mildly Bullish  | 113.20 - 115.00 | 115.00 |

- The energy crisis has left the JPY vulnerable and a test of major resistance at 115.00 beckons for USD/JPY. The pair will also find support from US yields, where our rates team still expect a further rise as market tightening expectations move towards those of the Fed. Locally, there might be greater interest than usual in Japan's monthly trade balance. Here the adjusted trade deficit is expected to widen towards the JPY500bn area. Any wider deficit could provide USD/JPY with the nudge through 115.00 as the market sinks its teeth into the energy dependence story. The week ends with the release of the September CPI figure, with ex food and energy expected still at -0.4% YoY. Clearly the BoJ is under no pressure to join in the race to tighter policy.
- US 3Q earnings season continues this week with some of the big tech names. So far the banks have performed well and seasonally equities tend to find support around now – suggesting that the safe haven properties of the JPY may not be in demand.

GBP: Tightening expectations run wild

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| GBP/USD | 1.3750 | Mildly Bearish  | 1.3650 - 1.3800 | 1.3600 |

- GBP has done some damage to those taking a view that stagflation would be GBP negative. Instead, the first reaction is for GBP to be rallying along with BoE tightening expectations. In our experience flat or inverted yield curves are good for currencies and only when a central bank responds to a policy mistake (i.e. reverses tightening) would a currency sell-off. Thus it has been too early to sell GBP on a policy mistake argument.
- The big question for the market is whether the BoE wants to protest against market pricing of an 8bp rate hike as early as November 4th and a further 14bp by the 16 December BoE rate meeting. This week sees September UK CPI – upside risks seen to the 3.2% YoY consensus. And we will also hear from BoE speakers, including the Governor, Andrew Bailey. Most of his speeches seem to be on climate change topics, but Chief Economist Huw Pill also speaks later in the week. He has warned about the persistence of inflation. A rate protest may not be forthcoming from the BoE this week and it seems that GBP can stay bid.

AUD: Chinese growth data may limit further upside

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| AUD/USD | 0.7422 | Mildly Bearish  | 0.7310 - 0.7460 | 0.7300 |

- AUD has been at the forefront of the pro-cyclical/commodity currency rally this week, as markets largely overlooked some quite grim jobs data in Australia, which clearly showed the deep impact of recent Covid-19 restrictions in the country. Other data releases are set to feel the drag of the summer Covid crisis, but it is possible markets are already factoring a period of bad data, and given the RBA has already pledged to keep policy on hold until February (i.e. not much room for rate expectations to fall further), there may be only a contained amount of damage an unsupportive data flow can do to AUD.
- Either way, the week ahead will not see any market-moving data releases in Australia, while some focus should be on the October RBA policy meeting minutes. It will be interesting to see whether the higher inflation debate is starting to create some diverging views among members about the so far ultra-dovish stance, but apart from that, the market impact should be contained. AUD should remain moved by external factors next week: China's GDP numbers will likely be key in this sense, especially as AUD seems to have recently enjoyed a reduction of any risk premium connected to an economic slowdown in China. We see downside risks compared to the consensus 5.0%, which could generate some shockwaves in currencies like AUD that have a high beta to China's sentiment. This could mean that, despite the energy story still offering some support, AUD/USD may struggle to push through the 0.7460 September high.

NZD: Inflation spike to cement hawkish RBNZ expectations

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| NZD/USD | 0.7071 | Neutral | 0.7000 - 0.7100 | 0.6900 |

- While not directly benefitting from higher energy prices, the Kiwi dollar is enjoying a strong risk environment and rising inflation expectations. Given the current RBNZ hawkish, markets are clearly expecting higher inflation will trigger a reaction by New Zealand policymakers, which is ultimately keeping rate expectations, and NZD, well supported.
- Next week sees the release of 3Q inflation, which is widely expected to have risen above the 4.0% mark, and should keep markets quite comfortable with the current 110bp of tightening priced in for the next 12 months. However, as discussed in the AUD section above, a risk of below-5% growth figures in China may cripple those currencies that have a natural high beta to Chinese sentiment. Unlike AUD, NZD is also the only overbought G10 currency vs the USD [according to latest CFTC data](#), and is therefore looking at some position-squaring-related downside risk.

CAD: Inflation set to confirm need for tapering

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/CAD | 1.2360 | Neutral | 1.2260 - 1.2500 | 1.2400 |

- CAD's rally continued this week, with USD/CAD breaking decisively below 1.24. The focus next week will mostly be on Canada's CPI numbers for September. We think that a headline rate around 4.0% should allow markets to further reinforce their view around the prospect of the Bank of Canada ending QE by year-end. Any above-consensus read may fuel speculation that the Bank will start tightening earlier in 2H22 and add support to CAD. Still, we don't think the USD correction has long legs, so USD/CAD downside potential should be more contained in the week ahead.
- One topic that should attract increasing market interest is the Bank of Canada mandate, which is due for renewal by the end of this year. The topic of inflation targeting is obviously quite hot, and rising inflation has been quite central in the latest election's debate. We are inclined to think the current inflation target (2%, with a +/- 1% tolerance band) will be renewed, although there is some speculation it could be made more flexible, like in the US.

CHF: US Treasury Report in focus

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/CHF | 1.0720 | Neutral | 1.0700 - 1.0800 | 1.0800 |

- EUR/CHF is under pressure again and it is not clear why. It has now dropped to levels (1.0700) where the SNB is taking an interest again in terms of FX intervention. On that subject, the US Treasury should be releasing its FX report around now. [We expect Switzerland to still be ticking all three boxes](#) when it comes to the currency manipulator tag, but yet still avoiding the designation in line with the softer stance of the Yellen Treasury.
- We read that some think that the CHF is a good stagflation hedge, since the SNB would tolerate a stronger CHF to insulate against the inflation risk. However, given that the SNB has been battling deflation for well over a decade, one could argue that it would welcome the pick-up in prices from imported energy and would not wish to snuff out the first signs of inflation with a stronger CHF. A sustained break below 1.07 would certainly be a surprise.

NOK: Is a November hike under consideration?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/NOK | 9.7500 | Neutral | 9.6500 - 9.8600 | 9.8000 |

- Once again, NOK is ranking as one of the top G10 weekly performers, finding itself on the perfect spot to benefit from surging energy prices while being backed by a strong tightening cycle. On this last point, the rise in September's inflation to 4.1% is not only fully endorsing the Norges Bank plan to hike again in December, but possibly fuelling some speculation the hike could be even brought forward to the 4 November meeting. Let's see whether NB Governor Oystein Olsen provides any hint in this direction at his speech on Wednesday.
- Aside from this, the data calendar is quite empty in Norway next week, and external factors will continue to dominate. Any further increase in oil prices past the \$85/bbl mark will likely keep NOK bid even if global risk sentiment proves less supportive.

SEK: Looking for hawkish hints

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|---------|-----------------|------------------|----------------|
| EUR/SEK | 10.0100 | Neutral | 9.9500 - 10.0500 | 10.1000 |

- Inflation has taken centre stage in Sweden this week. Following a moderate increase in the Prospera CPIF inflation expectations (to 1.9%), the hard data for September showed another acceleration in prices, with CPI YoY touching 2.5% and CPIF reaching 2.8%, although slightly below consensus expectations. This is clearly adding pressure on the ultra-dovish Riksbank to start pencilling in some rate hikes into their policy rate projections, which are currently flat at 0.00% through 2024. Markets seem to be betting that the Bank's pledge to keep rate unchanged will not hold for long, and are pricing in 23bp of tightening in the next 12 months and 50bp in the next 24 months.
- Despite no market moving data, we have a plethora of Riksbank speakers (including Governor Stefan Ingves) in the week ahead, and we expect that any signal that the Bank is getting more concerned about inflation may come to the help of SEK, although there may be some reluctance to price in much more than what is currently embedded in the OIS curve. EUR/SEK set to keep testing the key 10.00 psychologic level in the coming days.

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