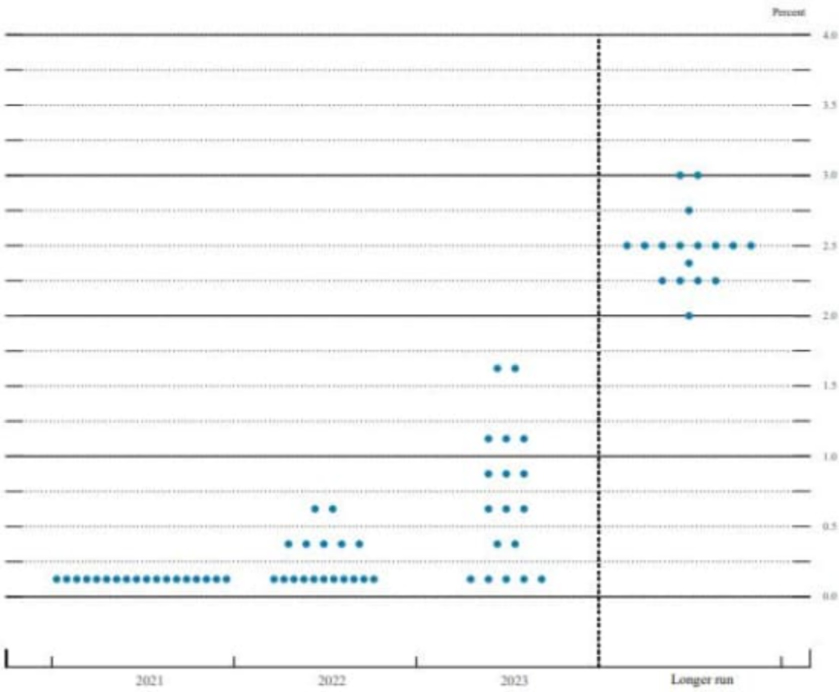
G10 FX Week Ahead: Talk on the dotted line

With the Fed dots having done so much damage to positioning, the focus for the week ahead will be on a host of Fed speakers - and whether they're as hawkish as the dots suggest. Potential hints at QE tapering in September would add further support to the dollar. Best protected will be those currencies where central banks are hawkish – such as in Canada and Norway



USD: Fed speakers dominate the US event calendar

	Spot	Week ahead bias	Range next week	1 month target
DXY	0.0000	Mildly Bullish	91.3000 - 92.8500	92.0000

- DXY has seen a classic short squeeze – the trigger being that 7 of 18 FOMC members felt that a first rate hike could come in 2022. Interestingly, the response has been felt harder in FX than US Treasury markets, where the search for carry still sees strong demand at the long end of the curve. You would say that the chances of a bond tantrum are less, but that movements at the shorter end of the US yield curve are a dollar positive – especially against the low yielders. The US data calendar is light in the week ahead, but there are several Federal Reserve speakers every day. The highlight may be Fed Chair Powell's testimony to Congress on Tuesday. Let's see whether the Fed is prepared to adopt any new language on tapering. Were views to coalesce around tapering actually starting in September – not December - the dollar could rally further.
- While the Fed is turning a little more hawkish, we'll also see some more emerging markets likely start their tightening cycles next week. Here we expect 25bp in the Czech Republic and potentially 50bp in Hungary. While tightening cycles are unlikely to be as aggressive as those in Russia and certainly not Brazil, they should still provide support to local currencies in the face of a slightly stronger dollar.

EUR: Hiccup in the European manufacturing sector?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1918	Mildly Bearish	1.1835 - 1.1980	1.2000

- The Fed hit EUR/USD view – and it was a surprise to see that our bullish EUR/USD view had become the consensus. Price action has all the hallmarks of a short, sharp position adjustment – suggesting the bulk of the correction may have occurred. Yet we feel Fed speak could see EUR/USD correct a little further lower this week. Look out for speeches from ECB President Christine Lagarde and board member Isabel Schnabel – likely to repeat remarks by Chief Economist Philip Lane distancing the central bank from any early hawkishness.
- In terms of the data calendar, the eurozone focus will be on the flash June PMIs and the German Ifo. We noticed this week that the Ifo institute cut their 2021 German GDP forecast to 3.7% from 3.3% on the back of supply bottlenecks. Let's see whether manufacturing sentiment sours a little in the June surveys.

JPY: Exiting deflation

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.09	Neutral	109.50 - 110.90	110.00

- The Japanese yen actually outperformed in this corrective rally – largely because speculators were short JPY already. However, the carry trade is not dead (indeed it may last until summer 2022) and the JPY will be one of the preferred funding vehicles now that funding in dollars carries a health warning.
- Locally, we see that Japanese core CPI moved back above zero in May – the first positive reading in just over a year. Yet it is a reminder that the Bank of Japan will be the last in the G10 to hike – if at all before the next recession comes along. Look out for June PMIs this week and also whether there has been any pick up in foreign buying of Japanese stocks. We suspect foreigners may want to position for Japanese reopening in 3Q – which could help keep a lid on USD/JPY in an otherwise bid environment.

GBP: Near term balance of risks points to weaker sterling

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3900	Mildly Bearish ↘	1.3710 - 1.4050	1.4100

- The next few weeks could be a vulnerable period for cable. First, the near-term EUR/USD upside potential has faded and short-term downside risks remain following the hawkish June FOMC meeting. Second, concerns about the spreading Delta variant should prevent any further hawkish repricing of the market outlook for the Bank of England. Third, the political risk factor is back, with growing signs that the UK government may want to unilaterally extend a grace period for processed meat exports to Northern Ireland that expires at the end of June. This would risk a tariff response from the EU.
- It is a busy week on the domestic data front. We don't expect much surprise from the BoE meeting (Thursday) and the Bank is unlikely to say anything new after signalling it would not speculate on the timing of a first interest rate move. Also note that no new forecasts will be present in the June BoE meeting. As for the June PMIs (Wednesday), we may see a slight increase in the services index again, though the manufacturing PMIs may reverse lower modestly after the meaningful rise last month.

AUD: Strong labour data points to RBA normalisation

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7538	Mildly Bullish	0.7400 - 0.7680	0.7700

- The Australian dollar was hit by the hawkish Fed this week but domestically, the very strong employment data (May unemployment rate fell to 5.1% vs consensus 5.5%) this week is set to make the 7 July RBA meeting very interesting. The RBA minutes did not reveal anything new but among the four possible options presented in terms of the future of the QE programme, our economists favour the one of scaling back the amount purchased or spreading the purchases over a longer period. With the RBA moving towards the first step of policy normalisation (albeit admittedly not being as hawkish as the Bank of Canada or the Norges Bank), this should give some support to AUD over the summer.
- Data-wise, we have May retail sales (Monday) and June PMIs (Wednesday), but neither should impact AUD too much. In terms of domestic data, the unemployment figures this week were crucial. In terms of external factors, the wider direction of the US dollar will be key next week. While the downside risks to AUD/USD remain for next week (particularly after AUD/USD broke the crucial 200-day moving average support level this week), the pace of the decline should be more limited vs the price action observed this week.

NZD: Near-term downside but recovery over the summer

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6988	Mildly Bullish	0.6900 - 0.7100	0.7100

- While domestic fundamentals continue to point to strength in the New Zealand dollar (i.e. the 1Q GDP released this week was strong, meaningfully surpassing the consensus expectations: 1.6% quarter-on-quarter vs the consensus at 0.5%), the external environment matters more. The hawkish Fed and the rebound in USD are clear near-term risks for NZD/USD and suggest caution for next week. Yet, with the earlier Fed tapering now expected and more than two months to Jackson Hole, we expect the fundamentally sound NZD to recover over the summer. Interestingly, despite the meaningfully larger long speculative positioning in NZD vs AUD (where speculative positioning is modestly short), NZD did not underperform AUD – underscoring the solid domestic NZ story.
- On the data front, it will be a quite week. 2Q consumer confidence (Monday) and May trade balance data (Thursday) should not affect NZD much next week. NZD/USD will be largely about the dollar and the upcoming communication from various FOMC members scheduled for next week

CAD: Time to jump back on the Canadian horse?

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2370	Neutral	1.2260 - 1.2430	1.2200

- USD/CAD has witnessed a classic short squeeze. Like fellow commodity currencies, the toxic cocktail of Fed hawkishness and Chinese commodity intervention has taken its toll on heavily-backed trades. Yet it looks like the BoC will be well ahead of the Fed in tightening policy and now that the majority of the correction is over, speculators will be looking to reset CAD longs. The 100 day moving average at 1.2430 may be the area to try this.
- Canada's data calendar is light this week – just April retail sales which are expected to fall 5% month-on-month with Canada in lockdown. We will also see the June release for the CFIB business barometer – which may well retest the highs at 68.2.

CHF: SNB selling FX reserves?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0949	Mildly Bullish	1.0900 - 1.0980	1.1000

- EUR/CHF is turning a little higher. It is hard to blame this on the Swiss National Bank meeting, which highlighted that rates would stay at -0.75% and FX intervention would continue if required. Interestingly, one of the Swiss banks suggested that the SNB may have been selling FX reserves earlier this year. If true, that would be a dangerous game for the SNB. Who would want to sell CHF if they knew the SNB wanted to off-load its large FX reserves (shrink its balance sheet) at slightly lower CHF levels?
- The week ahead will see the KOF update its economic forecasts. There are probably upside risks here given that Swiss business sentiment has been surging recently. As an aside, the SNB did recently revise up its inflation profile – but with forecast inflation still below 2.0% YoY in late 2022/23, the SNB, like the BoJ, will be one of the last to tighten – and the CHF should be at the forefront of losses in the face of any further dollar strength.

NOK: Hawkish NB to prevent meaningful NOK underperformance

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.2500	Mildly Bullish	10.1340 - 10.4120	10.1000

- The Norges Bank signalled a September rate hike at the June meeting and cemented its place as the most hawkish central bank in the G10 FX space. Yet, the positive spill over into the krone was rather brief and the impact from the Fed on cyclical FX (including NOK) mattered more. While EUR/NOK is now above 10.20, we expect the tailwind of the hawkish NB to limit any further decline in the krone. We also think it may be too early to wave a white flag for carry trades going into the summer, and with NOK likely to benefit from the highest implied yield in the G10 FX space by the year-end, the currency should stay supported over the summer.
- Next week, the risk to EUR/NOK remains to the upside but we expect the krone's weakness to eventually fade and NOK to recover in the summer months. It is a very calm week on the Norwegian data front, meaning that the general risk sentiment will remain the dominant driver of EUR/NOK.

SEK: Krona won’t stand out among cyclical FX

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2240	Mildly Bullish	10.1360 - 10.3050	10.1500

- Sweden's krona also felt the heat of the hawkish Fed and EUR/SEK broke above 10.20. Some stabilisation in G10 FX today tentatively suggests that the worst of the sell-off might be behind us (i.e. UST 10y yield is back below 1.5%). But even if the risk environment stabilises over the summer, SEK should lag its regional peer NOK and the cyclical CAD, as the Riksbank is set to remain decisively cautious, with rate hikes this year and next off the table. With EUR/USD struggling and limited upside potential to the cross going into the summer (as EUR may be turn into the favoured funding currency) SEK should benefit less as a result.
- Next week, risks are skewed to higher EUR/SEK but we expect the 10.30 level to hold. On the domestic front, it is not as quiet as in Norway, but the data should have limited importance for SEK. May unemployment rate (Tuesday) and May PPI (Thursday) should have no effect on the krona.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

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