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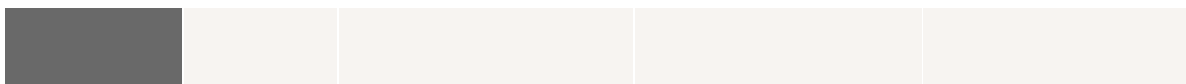
FX

G10 FX Week Ahead: Italian overhang

Ongoing budget discussions between Rome and Brussels will dominate the week - especially with the overhang of sovereign ratings. The key decision here will come from S&P after the close on Friday (Oct 26th), suggesting EUR/USD upside will be limited. Strong 3Q18 US GDP should keep the dollar bid and central bank meetings will be key for EUR, CAD, SEK and NOK



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EUR: Cruising for a bruising

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1490	Bearish 	1.1320 - 1.1570	1.1500

- As our economists note, the US data highlight will be 3Q GDP, with another strong outcome looking likely. Consumer spending continues to be supported by massive tax cuts and a robust jobs market, whilst healthy corporate profitability and a positive economic outlook are encouraging investment. Net trade is likely to swing back sharply after providing huge support to growth in 2Q, but this will at least be partially offset by some rebuilding of inventories. As such, we look for US growth to come in at an annualised 3.6% rate versus the 3.2% consensus and the 4.2% outcome from 2Q18. This should keep US rates firm and the market continuing to guess where the top is for the Fed Funds cycle. Higher US rates are also making hedging USD forward exceptionally expensive for European corporates and probably seeing lower USD hedge ratios than would otherwise have been the case.
- For the Euro, the week ahead will largely be about the Italian budget and the ECB. On the former, expect further dialogue between Brussels and Rome through the week, although it seems unlikely Italian politicians are prepared to back down from manifesto pledges. Moody's could be downgrading the Italian sovereign anytime now (currently rated Baa2 on a negative watch). But the main event here will be whether S&P ratings merely switch their outlook from stable to negative or opt for a surprise downgrade next Friday (26th) which we don't think is priced in. On the ECB, our team think the press conference could be a little more dovish, but not alter the core view that QE is ending in December. And in fact, we're more worried by signs that the US:EU trade detente is coming to an end. US tariffs on European car imports is certainly not priced into the EUR and any indication that President Trump is losing patience with the EU would be greeted poorly.

JPY: Strong US growth to dominate

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	112.50	Mildly Bullish 	111.80 - 113.10	112.00

- With 85 of the 500 S&P stocks having released earnings the sense is that apart from Oil & Gas, most sectors are performing well. Better earnings have allowed US equities to recoup recent losses and if US GDP does deliver as we believe, US equities and the dollar should perform well. We'll also see a Beige Book release from the Fed (Wed) which should set the tone for an upbeat FOMC meeting Nov 8th. Notably, the recently released FOMC minutes exposed more focus on whether policy would need to move to a restrictive setting than there was concern about China and trade.
- The Japanese calendar sees October Tokyo CPI (Fri) - which could see headline ticking up to 1.5% YoY (consensus). Any positive inflation surprise could spur some subtle hawkish BoJ sentiment ahead of the 31 October BoJ meeting the following week. As our team in [Asia notes](#), the JPY is outperforming other majors by default in a shaky global risk environment. However, recent growth figures have been impressive - even the inflation figures - ignoring what is driving them, seem closer to their target than in a very long time. There is renewed chatter about BoJ normalization, and this is not being discouraged by BoJ Governor Kuroda. While this lasts, the JPY should do well.

GBP: UK political impasse wreaking short-term havoc

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3030	Mildly Bearish 	1.2920 - 1.3130	1.3400

- GBP/USD's slide from 1.32 towards 1.30 was largely a US dollar story - and to a lesser extent a Brexit impasse story (this was largely in the price at the start of the week). As another crunch EU Council meeting comes and goes without an agreement, the critical issue of the Irish backstop - the insurance policy that would kick in in the event of the UK leaving the single market and customs union - remains unresolved. UK data was also mixed - and this didn't help GBP's cause (despite wage growth ticking up to 3.1%). All of this leaves GBP/USD sitting at a crucial Brexit inflection point around the psychological 1.30 level - which is likely to now be a gauge of market sentiment. The slippery slope of a May leadership challenge, no Tory front-runner, calls for a general election and UK political impasse at a crucial juncture could come back on to the table and tip GBP/USD below the 1.30 level in the coming week - though it's getting pretty hard to make a solid forward-looking assessment of these short-term UK political risks (sentiment seems to be shifting every day).
- Our [economists](#) make the point that as Brexit negotiations stall, the ever-increasing uncertainty surrounding 'no deal' could see businesses take more concrete action and consumers turn even more cautious. For the Bank of England, this makes a rate hike unlikely before March 2019. They do not know for sure whether a 'no deal' will be averted until much closer to the UK's scheduled exit date (29 March 2019) - although we feel GBP markets will have a good sense of where things are going sooner rather than later. That suggests we're in a big move over the next couple of months (2M GBP/USD volatility particularly elevated relative to the rest of the term structure) - with the relative outcomes pretty binary: 'deal' seeing GBP/USD above 1.35 and 'no deal' seeing GBP/USD below 1.25. For the time being, with sentiment shifting every day - we doubt that spot investors will collectively be willing to chase a bearish GBP story. We suspect GBP/USD remains at a neutral point (1.30) - while bouncing around either side of that until we get clarity. The week ahead sees some BoE commentary (Haldane and Carney - both Tue) - though we doubt comments will shift short-term GBP sentiment too drastically.

AUD: No light at the end of the US-China trade war tunnel

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7110	Neutral	0.7040 - 0.7200	0.6900

- It was a big week of China-related event risks. On the one hand, there was some relief that the US Treasury didn't label China a 'currency manipulator' - although the two-page individual scrutiny on Beijing's FX policy suggests that the US administration has issued a strong yellow card warning to their Chinese counterparts. The response from the PBoC has been to fix the CNY weaker - and it suggests that USD/CNY is fast becoming a negotiating tool in the ongoing US-China trade tensions. Not seeing a light at the end of the tunnel here makes us very nervous about turning bullish on those currencies linked to the Chinese economic outlook - with AUD at the top of the list here in the G10 FX space.
- On the domestic AUD side, we think relative rate differentials, relative political risks (note 1H19 Australian federal elections), relative economic momentum will all be fairly negative for the currency in the near-term. This is likely to see the AUD underperform the G10 space - even if US-China trade tensions fail to escalate meaningfully. We still see risks of AUD/USD falling below 0.70 over the next few months (0.69 our 1M target). The week ahead is very quiet in terms of AUD event risks - with a couple of RBA speakers to watch out for throughout the week (DeBelle - Mon; Bullock - Tue).

NZD: Any short squeeze may be quickly faded given medium-term woes

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6580	Neutral	0.6500 - 0.6640	0.6400


- Rising speculation of a near-term RBNZ rate cut has been fuelled by waning business confidence – which has prompted the central bank to take a more dovish stance. We do think some of this sentiment is misplaced – although with the analyst consensus shifting towards RBNZ easing in early 2019, we suspect that this will likely keep the pressure on the kiwi in the absence of any positive data to dissuade investors.
- It's a quiet week in the New Zealand calendar - with only Sep trade data to note (Wed). We look for NZD/USD to trade largely on wider geopolitical sentiment in the coming week - although the lack of any escalation or fresh negative headlines could see short NZD bets partly unwind. But look for rallies to be brief and moves above the 50-dma (0.6590) to be faded - with sellers looking to capitalise on a medium-term bearish NZD outlook.

CAD: Will need an ultra-hawkish BoC message to drive the loonie higher

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3100	Neutral	1.2950 - 1.3150	1.2900

- The Bank of Canada meeting (Wed) will be the highlight of the week; the central bank is likely to continue its gradual tightening path and provide a 25 basis point rate hike. This should be no surprise, as headline inflation has been out of the BoC's comfort zone for some time now, hitting what it sees as its upper threshold of 3% YoY in July. And with all three of the main core measures floating around the 2% target, there is little reason for the BoC to hold off on pushing policy rates higher. Market expectations have marginally cooled over recent weeks (now only 78% priced in versus 95% at the start of the month). A follow-through of a hike should give CAD a knee-jerk boost; however, with a 100bp of tightening already priced in over a 2-year horizon, we think there's limited scope for a sustained rally in CAD - unless the BoC send an ultra-hawkish signal.
- We see this as highly unlikely - with the fragile global market environment, uncertainty over global trade and mixed Canadian data of late (in particular weak wage growth) likely to see a more 'dovish hike' from the BoC. We, therefore, wouldn't be surprised to see USD/CAD snapback higher following an initial post-meeting fall. Our short-term view remains that we see USD/CAD stabilising in the 1.28-1.30 range - with no directional conviction.

CHF: Bank secrecy laws weighing?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1420	Mildly Bearish 	1.1370 - 1.1470	1.1300

- Despite BTP:Bund spreads moving well out above 300bp, EUR/CHF has held up relatively well. It's been hard to put a finger on why the CHF is failing to take advantage of Italian political uncertainty, but perhaps news on the erosion of Swiss bank secrecy is playing a role. This month there has been focus on both: i) Swiss tax announcing they've shared details on 2 million accounts with other countries and ii) a Supreme Court ruling implying that Swiss bank secrecy laws stopped at the Swiss border. We'll have to take a closer look at the Balance of Payments data to see whether there's any evidence of increased outflows.
- For the week ahead, the Italian story probably means downside risks to EUR/CHF, with 1.1300 potentially being tested.

SEK: Riskbank confirming the key message

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	103,440.0000	Neutral	10.2710 - 10.4290	10.7000

- We don't look for any change from the Riksbank during the Wednesday's meeting (neither in the level of interest rates nor in the forward guidance) with the central bank confirming its intention to hike rates in either December or February. In our view, the improvement in core inflation in September could shift the balance of probability in favour of December, though a positive effect on SEK from the expected rate hike should be offset by the usual year-end seasonal krona decline (due to the falling interbank rates).
- Bar the Riksbank meeting, the focus will also be on the October Economic Tendency Survey (Thursday) and Sep retail sales (Friday), with both readings being fairly unchanged. With plenty of good news priced into SEK already and EUR/SEK being fairly valued vs our short-term financial fair value model, we don't expect EUR/SEK to break below the 10.3000 level.

NOK: Firmly staying above the 9.4000 support level

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.4540	Neutral	9.4000 - 9.5160	9.5000

- The Norges Bank meeting (Thursday) should be a non-event, following the dovish hike in the previous meeting. The NB is neither delivering new forecasts nor holding a press conference, and its statement is likely to remain largely unchanged. But the continued solid price pressure evident in the September figures, combined with a weaker than expected exchange rate and rising oil prices, suggest upside risk to the NB policy stance next year (currently the NB only envisages two hikes in 2019 with risk being skewed to three rate increases, in our view).
- With oil prices declining since early October and no clear catalyst from the NB for NOK to strength, we expect EUR/NOK to remain above the strong horizontal support level of 9.4000. Any further deterioration in risk sentiment in Europe (related to the Italian fiscal outlook and the standoff between Italy and the EU on the Italian budget proposal) should be modestly negative for higher beta, low liquidity NOK.

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