G10 FX Week Ahead: Third wave blues

The rising third wave of Covid-19 cases in Europe and the threat of a disorderly sell-off in US Treasuries still haunt risk sentiment. This is providing the dollar with some support. How well the European economy can cope will be in focus this week with the release of March PMIs. Elsewhere, the SNB should stick to the current policy mix at its rate meeting

USD: Waiting for the bond storm to pass

	Spot	Week ahead bias	Range next week	1 month target
DXY	92.0100	Neutral	91.3000 - 92.2000	91.0000

- Despite a dovish FOMC meeting the key takeaway from the event was a comment from our rates strategy team that the Fed had left the long end of the US Treasury market 'unprotected'. The subsequent spike in US 10-year yields to 1.75% certainly proved that point and fears of a disorderly sell-off in Treasuries still stalk the FX market. On that subject, FX markets will be starting the new week nervous about US Treasuries once again now that the Fed has decided not to extend the US Treasury exemption to the Supplementary Leverage Ratio.
- The US data calendar over the coming week is relatively limited. February personal income data will not repeat the bounce of January – but should surge in March as the $1,400 stimulus checks hit bank accounts. We'll also see lots of Fed speakers, including Fed Chair Powell testifying on Tuesday and Wednesday, alongside Treasury Secretary Janet Yellen. DXY remains supported largely by the sluggish roll-out of vaccines and new lockdowns in Europe – remember European FX has a 77% weight in the DXY. But arguably DXY should have done even better given the 70bp+ rise in US 10-year yields this year and the fact that it hasn't lent weight to our preferred bearish DXY stance in 2021. We would also say that supportive developments in EMFX can keep the dollar backdrop soft after sharper-than-expected monetary tightening in Brazil, Turkey and Russia.

EUR: Tomorrow never comes

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1880	Neutral	1.1855 - 1.2000	1.2100

- Europe's handling of the Covid-19 crisis certainly seems to be taking its toll on the EUR. Third waves now look a reality for the likes of France, the Netherlands and Italy, triggering fresh lockdowns and delaying the day when Europe can play its part in the global recovery. The slow roll-out of the vaccines and safety concerns over the AZ vaccine clearly have not helped either. Moving to the calendar this week, on Monday the focus will be how much the ECB increased its PEPP bond buying. An increase in net weekly buying to above EUR20bn would be seen as sizable and could provide some support to European debt markets and perhaps even slow the rise in US yields. Data-wise the highlights will be the first look at March PMIs for the larger European economies and the German Ifo. Let's see whether any optimism in the lagging services PMI starts to come through. We'll also see a whole host of ECB speakers.
- News that parts of Europe are heading back into lockdown may keep the EUR pressured for the short term. A revisit to the 200-day moving average, now at 1.1855, again looks the bias. Yet we see this as a temporary correction as Europe muddles through the crisis and still believe that a supportive risk environment can drag EUR/USD well back above 1.20 later this month and into April.

JPY: Making sense of the BoJ

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.00	Neutral	108.30 - 109.50	107.00

- Neither USD/JPY nor Japanese rates markets moved much on the BoJ's policy review, which it seems was aimed at more flexibility. More flexibility in JGB yields at +/- 25bp around 0% (though the BoJ claims this was unchanged), more flexibility in stock buying (no longer a target and now purchasing ETFs on the broader Topix) and more flexibility to cut rates (changes made on its three-tier reserve ratio exemptions). Perhaps the balance was about right, such that the market did not jump to the conclusion that the BoJ was ready to normalise policy.
- Expect USD/JPY to continue to trade off US yields for the time being – though again we expect to hear survey reports of Japanese Lifers increasing hedged foreign bond portfolios and reducing unhedged foreign portfolio bond weightings. On the subject of US yields, our bond strategy team also point out that we will not see another round of long-dated Treasury supply until the second week in April. This could take some of the upside pressure off both US yields and USD/JPY.

GBP: The bias remains for the return to the 1.40 level

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3850	Mildly Bullish ↗	1.3730 - 1.4000	1.4400

- It will be very busy week on the UK date front next week, but after the March BoE meeting this week (where the central bank did not lean against higher bond yields), these should have a limited impact on sterling. March headline CPI (Wed) is set to increase modestly, but we need to wait until April to see a more meaningful jump in prices. The January unemployment rate (Tuesday) should remain stable, March Service PMI (Wed) should move back in the expansionary territory but February Retail sales (Fri) are expected to only partially recover after January's sharp fall. Overall, the UK data releases next week should be no game changer for the GBP prospects
- We see the risk environment as likely to stabilise next week and a likely range bound EUR/USD, thus the similar trading dynamics should be present in GBP/USD. Still, the bias remains for modestly higher GBP/USD and the return back to the 1.40 level given the positive GBP outlook driven by the fast vaccination process and the expected sharp economic rebound in 2Q.

AUD: Stuck between mixed inputs

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7730	Neutral	0.7650 - 0.7820	0.7700

- The Aussie dollar saw a number of domestic inputs this past week which however left it trading not far from last Friday's closing levels amid a mixed global risk mood. The data-flow has been mixed as well: a plunge in retail sales for February poured some cold water on the Aussie recovery story after some very strong employment figures were released earlier in the week.
- Arguably, jobs data are more relevant for the Reserve Bank of Australia and considering that employment is back to pre-pandemic levels, the risk of the RBA feeling the pressure to tweak their lower-for-longer stance (which was firmly reiterated in the March minutes) is non-negligible. It is still highly likely that the RBA will stick to its very dovish tone for as long as feasible, considering how the bond market weakness remains a central concern for global central banks. Indeed, the big spill-over of US yields into the Aussie bond market will still limit the ability of the RBA to keep long-end yields capped, unless they opt for more drastic measures, such as extending the yield-curve-control to the 10-year tenor. In a Yield Curve Control perspective (on the 3-year tenor), it will be worth keeping an eye on the November 2024 auction next week to gauge any shift towards more hawkish views by the market. Otherwise, the Aussie calendar is empty and AUD will remain solely driven by global risk factors.

NZD: Growth reality check?

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7150	Neutral	0.7080 - 0.7220	0.7300

- The New Zealand domestic recovery narrative took a blow this week after 4Q GDP data showed an unexpected contraction (-0.9% YoY). The impact on the Kiwi economy of falling exported services (tourism and education) as borders were shut was probably underestimated as it offset the benefits of low restriction inside the country.
- What does this mean for the Reserve Bank of New Zealand policy? In our view, a weaker growth is not a game-changer for the RBNZ given that the two main measures determining the direction of monetary policy – inflation and unemployment – both showed very encouraging signs in 4Q (CPI YoY rose to 1.4%, unemployment dropped to 4.9%). Furthermore, the RBNZ latest economic projections did expect borders to remain shut until the end of 2021. Any hawkish shift by the RBNZ before 2H21 already looked unlikely, and in the next months we will get a number of fresh data that will either downsize or endorse the double-dip recession story, in the latter case, NZD upside potential will likely shrink. For now, NZD should remain driven by external factors, and there are no market-moving data in the week ahead to highlight.

CAD: Gauging BoC bond concerns amid oil headwinds

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2520	Neutral	1.2420 - 1.2620	1.2500

- No spikes in February's CPI numbers (a mild increase from 1.0% to 1.1%) were likely, which the Bank of Canada was hoping for to remain comfortable with its dovish message. The next inflation report will be released a few hours before the 21 April BoC policy meeting, where there are some expectations that the Bank may announce some additional tapering.
- Surely, the seemingly unstoppable rise in yields witnessed lately would argue that the BoC may take steps to try and put a curb to long-end yields, which have seen the biggest increase in the G10 space in 2021 (+92bp). After all, in its latest QE adjustment, the BoC did shift its purchases towards longer-dated bonds while tapering at the same time. We are inclined to believe the bond market will be in a healthier state by the end of April, but the risk of more "scary" spikes in yields is material between now and then, and would likely keep the BoC concerned. On this topic, we may get some comments by the BoC Deputy Governor Gravelle this week. On the data side, retail sales in January dropped by a smaller margin than expected today, and that was the last relevant piece of data before the January GDP numbers on 31 March. CAD has not been hit very hard by the slump in oil prices this week, but some stabilisation in crude will likely be needed to avert some bigger spill-over into the currency.

CHF: Steady as she goes from the SNB

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1055	Neutral	1.1020 - 1.1120	1.1200

- The highlight this week will be Thursday's Swiss National Bank policy meeting. Expect this to result in the familiar refrain of keeping rates at -0.75% and the threat of further FX intervention to weaken the CHF. Fortunately, market conditions have moved in favour of the SNB, where recovery hopes have seen defensive long positions in the CHF down-sized. In theory the SNB should be a little more upbeat on the activity story. 4Q20 GDP came in at +0.3% QoQ vs. flat expected and the KOF leading indicator remains strong.
- As an aside, we are watching developments in Poland regarding CHF mortgages. It is a complex issue, but Polish banks still have around CHF25bn worth of CHF mortgages on their books that need to be wound down. We'll have more on this story shortly.

NOK: Some stability after the volatile week

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.1670	Neutral	10.0210 - 10.3050	10.2000

- Although the NB delivered a hawkish message this week and brought the signalling of the first rate hike forward to late 2021, the NOK gains were short-lived with the krone's fall largely caused by the meaningful drop in the oil price and the declining equity markets. With the projected rebound in the eurozone and Norwegian economies from 2Q onwards, we see risks of Norges Bank eventually hiking rates earlier and possibly more this year. This should be a supportive factor for NOK in 2H. We see spikes in EUR/NOK higher (above 10.20) as an opportunity to fade the NOK weakness.
- It is a quiet week on the Norwegian data front next week. February Credit indicator and the March unemployment rate (both on Friday) should have a negligible impact on NOK. After the meaningful adjustment in oil prices lower, we expect EUR/NOK to stabilize around 10.20 level.

SEK: Trading around the EUR/SEK 10.10 gravity line

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1830	Neutral	10.1000 - 10.2670	10.1000

- The multi-month trading around the EUR/SEK 10.1000 gravity line continues and should remain intact next week. SEK remains less vulnerable during the risk-off periods than NOK and with the Riskbank remaining cautious and not signalling any rate hikes over the forecast horizon, the case for high conviction long SEK positions is not there at this point. Only once the eurozone economy rebounds in 2Q, then EUR/SEK should start testing the psychological 10.00 level more forcefully.
- On the domestic data front, neither February PPI inflation (Thursday) nor the Feb retails sales (Friday) should have a longer lasting effect on SEK. Any spike in EUR/SEK higher above the 10.2000 level should be brief and limited. The 200-day moving average EUR/SEK 10.2671 resistance should hold.

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