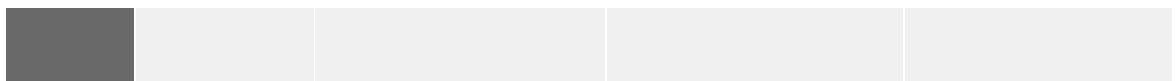


G10 FX Week Ahead: Dancing to the Fed's Balance Sheet Act

With four hikes priced in, the focus on the Fed balance sheet at Wednesday's meeting could see the pricing of the Fed terminal rate stall or reverse and the dollar decline. Geopolitics will also remain central, with Russia-Ukraine tensions in focus. Expect CAD outperformance as the BoC hikes, while [Italian politics](#) may generate some jitters in EUR/CHF



Source: Shutterstock



DXY: Correction may have more to run

	Spot	Week ahead bias	Range next week	1 month target
DXY	95.5200	Mildly Bearish 	95.1500 - 96.0000	97.0000

- The highlight of the week ahead will be Wednesday's FOMC meeting, where our team expect the Fed to announce the end of QE prematurely and signal a readiness to hike in March. Given that four hikes are already priced this year, the focus on the Fed balance sheet could see the pricing of the Fed terminal rate stall/marginally reverse and be mildly dollar negative. Additionally, next week sees a heavy slate of US tech, financial and industrial 4Q earnings – leaving US equities in a vulnerable position as bond yields rise too.
- In terms of data, we'll get our first look at 4Q21 US GDP data – expected near 5% QoQ annualised after soft December figures. More important will be the 4Q Employment Cost Index on Friday. Any above consensus figure could see the dollar end the week on a stronger footing on the view that second-round inflation effects were emerging in the labour market. Geo-politics will also be present though the week, as Russia-Ukraine tensions continue. Any escalation should be a clear dollar positive – on the view that Europe's dependence on Russia's energy exports will be exposed even more.

EUR: Business sentiment under scrutiny

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1357	Mildly Bearish 	1.1300 - 1.1420	1.1200

- A slightly softer dollar environment around the Fed could see EUR/USD trade up to the 1.1415/20 area, though we do not expect gains to last. Locally the week starts off with the release of January PMIs for the Eurozone, Germany and France. Small declines are expected as the continent battles both Omicron and higher energy prices. Further insights into German business sentiment comes with the German Ifo. Notably, the ECB has also been sticking to its position that it does not need to follow the Fed with higher rates this year.
- It is hard to see any real geo-political risk premium being priced into the EUR yet. Yet undoubtedly the risks, including aggressive sanctions against Russia, would hit Europe's growth projects far harder than those of the US – plus the spike in energy costs would hit the euro via the Terms of Trade channel. Elsewhere, the EUR will keep on eye on political developments in Italy – see below.

JPY: Tug of war between higher bond yields and lower equities

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	113.65	Mildly Bearish 	112.75 - 114.50	116.00

- The JPY has been strengthening on the crosses as the global equity market correction gains traction. Somewhat surprisingly, 4Q21 US earnings have hit equity markets and more are to be released this week – especially some high-profile US tech stocks. The JPY has consistently shown a negative correlation with US equities and cross rates like AUD/JPY risk getting hit hard should equities extend losses.
- Developments in Japan have had little bearing on the JPY for a long while now (including even BoJ view changes), but if the ultimate achievement of the Fed is to increase real US rates – plus energy prices remain high – we would expect continued demand for USD/JPY on dips near 112.50.

GBP: Settling in

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3565	Neutral	1.3500 - 1.3650	1.3500

- Market pricing of the BoE rate cycle has barely budged recently. Pricing a 25bp hike at the 3 February meeting remains around 90%, although GBP has given up some of its gains on the softer December retail sales data. Politics has yet to hit GBP on the view that even if PM Johnson were to resign, Chancellor Sunak would be seen as a safe pair of hands as an alternative.
- For the week ahead, there may be some focus on UK-EC negotiations over Brexit – key officials meet on Monday. Our point last year had been that a no deal is not much worse than the current deal – thus GBP should not be too badly hit on any negative headlines. Overall, expect the BoE tightening story to keep GBP supported on dips. Additionally the heavy weighting towards Materials and Energy sectors in UK FTSE benchmark may provide UK equities with some insulation.

AUD: Another tick higher in inflation, but RBA tightening still far

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7207	Mildly Bullish ↗	0.7170 - 0.7260	0.7200

- AUD/USD flattened up this week, following swings in sentiment while finding some support from a bigger-than-expected drop in Australia's unemployment in December (to 4.2%). The Reserve Bank of Australia is now presented with a question of whether to react to such improvements in the jobs market with a significant hawkish turn at the 1 February meeting, with the counter-argument still related to growth concerns as Western Australia keeps delaying reopening plans due to the ongoing Covid outbreak.
- Next week, we are likely to see another tick-up in inflation in 4Q from the latest 3.0% read. While not very high compared to similar markets, it could still fuel some hawkish speculations on the RBA and help AUD, even though we doubt the RBA tightening is a story for the first three quarters of 2022. Some retreat in the USD could also help AUD/USD build some support at 0.72.

NZD: Another big jump in inflation

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6735	Mildly Bullish ↗	0.6690 - 0.6800	0.6900

- It's CPI week in New Zealand, and expect the headline rate to jump again in the 4Q21 read, possibly touching 6%. The market's tightening expectations for the Reserve Bank of New Zealand are already quite aggressive (a 25bp hike in mid-February and at least five more in 2022), but we think that a strong CPI read may fuel speculation that the Bank will go for 50bp in February, which should be translated into a stronger NZD.
- We think NZD/USD can make its way back to the 0.6800 mark next week, although that clearly relies on a stabilisation in the overall risk environment.

CAD: We expect a rate hike by the Bank of Canada

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2520	Bearish 	1.2400 - 1.2580	1.2400

- A tight labour market, inflation close to 5%, investments and hiring intentions at record highs and oil prices back to pre-Omicron levels: all this is pointing to the need to start raising interest rates in Canada. The current restrictions in Ontario – which are however due to be eased at the end of next week – make it a close call, but we think the Bank of Canada will hike interest rates by 25 basis points on Wednesday.
- The market is currently attaching a 70% implied probability of a hike, which leaves some room for the CAD to appreciate after the announcement, especially as that should reinforce the view that the BoC will lead the Fed tightening by 1-2 months and by 25-50 basis points. We expect a drop in USD/CAD to the 1.2400/1.2450 area if our expectation for a hike prove correct.

CHF: Mostly downside risks from Italian politics

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0347	Neutral	1.0270 - 1.0400	1.0400

- Keep an eye on Italian political developments in the week ahead, as the parliament meets to vote for the new President of the Republic. As discussed in [“A market's guide to Italy's upcoming presidential election”](#) the most likely scenario appears to be a move by Mario Draghi from the role of Prime Minister to the (largely ceremonial) role of President. While potentially fuelling concerns about the implementation of the EU-funded reforms in the country with Draghi leaving the government, we think markets may welcome the fact that: a) Draghi will remain in the political picture for the next seven years (his government is due to end in the Spring of 2023); b) no divisive candidate (like the other main contender, Silvio Berlusconi) is elected president.
- EUR/CHF seems to be pricing very little of a shake-up in the Italian bond market, which means that most of the risks are skewed to the downside for the pair. Domestically, it's worth keeping an eye on the KOF leading indicator for January. With the Swiss National Bank looking less concerned about a stronger CHF, we might see the downtrend extend to the 1.02/1.03 area should the Italian bond market come under pressure.

NOK: Waiting for sentiment stabilisation

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.0600	Neutral	10.0000 - 10.1500	9.9000

- It's going to be a rather quiet week data-wise in Norway, with some focus only on December retail sales and Norges Bank's Wealth Fund key figures for 2021. The slump in global equities has been the major factor driving EUR/NOK this week, with today's big move to 10.10 entirely due to NOK's high sensitivity to equity dynamics.
- This week, we heard from Norges Bank on monetary policy: while pausing the tightening cycle for now, policymakers signalled a move in March, thereby consolidating the credibility of the Bank's hawkish rate projections for 2022. [As discussed here](#), we think the case for four hikes this year is getting increasingly strong, and this should provide extended support to NOK. For this week, some stabilisation in sentiment is surely needed to send EUR/NOK back to or below the 10.00 level.

SEK: US tech woes hitting the krona

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.4100	Neutral	10.3600 - 10.4900	10.3000

- SEK is the currency with the highest positive correlation with the US tech stock market, and the recent woes in the segment (Nasdaq entering correction zone) have been a major contributor to the weak start of the year for the krona.
- We'll need to see signs that US tech shares are recovering some ground next week to see EUR/SEK converge to the centre of its 10.20/10.40 range in which it traded in December and at the start of January. Some help may come from the Prospera Inflation Expectations survey should CPIF expectations climb significantly. Later in the week, some focus will be on jobs and retail sales data, as well as on the Economic Tendency survey for January.

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.