

## G10 FX Week Ahead: Less 'stag' more 'flation'

The G10 FX week ahead will be dominated by fresh growth and inflation numbers and how they play into the stagflation narrative. We're less worried about the 'stag', particularly when it comes to the US and expect the hawkish re-pricing of the Fed curve to keep the dollar supported. Also in focus will be central bank meetings in the eurozone, Canada and Japan



## USD: Re-connecting with Fed re-pricing

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.6400	Mildly Bullish 	93.3000 - 94.3000	95.0000

- The dollar rally has stalled recently even though interest rate markets continue to hawkishly re-price the Fed policy cycle. Explaining that may be the better risk environment, where 3Q earnings have come in on the strong side and renewed interest has been shown in the commodity pairs on the back of supply challenges in this sector. Expect to hear a lot more about 'stagflation' this coming week – given that we will get fresh updates on growth (3Q US GDP on Thursday) and inflation (the Fed's preferred price measure, core PCE deflator, released Friday). Our US macro team has a firm view here. We're less worried about the 3Q slowdown (less 'Stag') and more worried about persistent price pressures ('flation'). Here the core PCE deflator should push up to a new high of 3.7% YoY and provide some fodder to a new theme emerging from the Fed (Quarles, Waller) that high inflation over coming months could bring forward rate hikes.
- The week will also see a heavy slate of 3Q US earnings, including tech heavyweights. With 111 of 500 S&P index companies so far reporting, sales and earnings have positively surprised in nearly every sector (ex energy). Thus it looks like high prices can be passed onto the consumer. The Fed will be wary of this heading into their November 3rd meeting. We favour continued strength in the dollar against the low-yielders and energy importers in particular. Elsewhere, and after last week's surprising large cut in Turkey and large hike in Russia, the EM monetary policy focus this week turns to Brazil. Here a 100bp hike has been communicated and is expected, with risk that BACEN does even more given the weak BRL.

## EUR: You say it best, when you say nothing at all

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1630	Mildly Bearish 	1.1550 - 1.1685	1.1500

- The highlight of the week will be Thursday's ECB meeting. Here the ECB will be caught between; a) acknowledging that inflation risks have increased and b) wanting to push back against market pricing of an ECB hike in late 2022. Typically the ECB would try to navigate this path by not saying too much and passing the buck to a full review coming at the December 16th meeting. In addition to the ECB, the stagflation story will be very much front and centre in the Euro area too, where we get a first look at 3Q21 GDP data (ING 1.9%, consensus 2.1%) and October inflation (ING 3.6% YoY, consensus 3.7%). Again, growth is looking ok, but the persistence of inflation is a key theme.
- So far the EUR/USD correction has stalled at resistance at 1.1670/80. Our short term Financial Fair Value (FFV) models, looking at short term yield spreads, yield curves and risk sentiment point to a 2% overvaluation of EUR/USD – largely because short-dated US yields have continued to power ahead. This time next week we would expect EUR/USD to be trading decisively under 1.16.

## JPY: Big update from the BoJ

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	113.90	Mildly Bullish ↗	113.00 - 115.00	115.00

- The USD/JPY rally has taken a breather over the last week after some strong gains. The highlight of the week ahead will be Thursday's Bank of Japan meeting where a fresh update on the Outlook for Activity and prices will be published. Back in July, the BoJ had forecast CPI at 0.6%, 0.9% and 1.0% in FY21-23 respectively. We doubt there will be any substantial upward revisions which will prompt a re-pricing of the typically super-dovish BoJ policy cycle.
- On USD/JPY, we do not want to miss out on a big upmove through 115.00. We have a conviction call that the Fed will have to turn more hawkish – \$ positive against the low-yielders. And a call that the energy crisis is here to stay over coming months with low inventory levels in the northern hemisphere. We are already starting to see the Japanese trade deficit widen on energy and will see if the October figure pushes towards the JPY1tr area. We are very bullish on USD/JPY and see the correction finding support somewhere in the 113.20/70 area.

## GBP: Settling into the hike

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3790	Neutral	1.3700 - 1.3850	1.3600

- The broad, trade-weighted measure of the pound is at the highest levels since the aftermath of the Brexit vote in 2016. Driving that strength has been the aggressive re-pricing of the Bank of England cycle, where a 15bp hike now looks fully discounted for the November 4th BoE meeting. While the BoE may try to rein in some of the more aggressive tightening being priced (e.g. a Bank Rate at 1.25% by end-2022), we suspect the first in what should be a series of hikes (amidst CPI heading to 4-5% next six months) will keep GBP bid on dips. That strength should be felt more against the EUR than the USD, however.
- Having heard from Governor Bailey and new Chief Economist Pill, it seems that any push back against the impending hikes may only come from external doves – such as Silvana Tenreyro who speaks next week. Yet market expectations look set. The UK data calendar is quiet, but GBP money markets may continue to take notice of European gas prices, where supplies are tight and a bidding war seems likely over coming months. Higher gas prices have driven both UK money market rates and GBP higher over the last month.

## AUD: Decelerating inflation to argue in favour of RBA dovishness

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7500	Mildly Bearish 	0.7400 - 0.7550	0.7400

- The Reserve Bank of Australia intervened for AUD 1bn on Friday to defend its 0.10% yield target on the April 2024 government security. At the time of writing, the yield is around 12bp (it traded at 17bp before the RBA intervention). That is sending quite a clear signal to the market that Australian policymakers are either not turning any less dovish or that anyway they will not use a lighter touch to YCC as a tool to add a hawkish bias. Our feeling is, however, that markets may have not fully endorsed these two notions, and we would not be surprised to see more bearish bets on the April 2024 bond down the road. We still think, however, that the RBA will continue to intervene until formally announcing it is dropping its YCC, so any benefit to AUD from market speculation in this sense should prove time-limited.
- The Evergrande story in China appears to have taken a less concerning path, and this is clearly benefitting the highly exposed AUD. Still, we think there were indications that the market had already turned quite relaxed on the impact of the Evergrande debt crisis, and it seems hard to see any more significant upside room for AUD on the back of this story. In the week ahead, AUD will face the test of 3Q CPI data out of Australia. Markets are widely expecting a deceleration from the 3.8% 2Q figure as Covid restrictions generated some deflationary pressures in late summer. Consensus is reported at 3.1% for the headline rate, but could actually be a bit higher after New Zealand's very strong (4.9%) read for the same quarter. Anyway, decreasing price pressures should all but underpin the RBA's dovish stance and we think the release may prompt some re-pricing of tightening expectations (40bp priced in for the next year) and weigh on AUD.

## NZD: Starting to flirt with a 50bp hike?

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7160	Neutral	0.7100 - 0.7220	0.7000

- The Kiwi dollar is the best-performing G10 currency this week, buoyed by better global risk sentiment and strengthening expectations around Reserve Bank of New Zealand tightening. Markets have slowly started to speculate on a possible 50bp rate hike at the 24 November central bank meeting. Despite the RBNZ communication clearly pointed at a gradual approach to raising rates, we would not completely rule a 50bp move out just yet. Still, we would probably need to see a very strong 3Q jobs report in two weeks' time to consider it as a likely option.
- In the week ahead, only September trade data will be in focus in an otherwise quite dull data calendar in New Zealand. Global risk factors should remain in the driver's seat before the 3Q jobs data, and we think we could see NZD/USD could find some consolidation after a quite extended run in the week ahead. Still, the risks appear tilted to the downside in the short-term, as NZD seems to be having a lot of positives in the price, and NZD/USD is currently around 2% above its short-term fair value.

## CAD: BoC to taper, but may fall short of aggressive tightening expectations

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2330	Mildly Bullish 	1.2300 - 1.2430	1.2400

- In our view, the rally in CAD is looking quite tired, and we expect to see more support in USD/CAD around the 1.2300 level. Most of the positives (BoC tightening, solid economic recovery, higher energy prices) appear in the price and our short-term fair value model currently shows a 1.5% undervaluation in USD/CAD.
- The Bank of Canada meeting week might prove to be a catalyst for an upside correction in USD/CAD. As discussed in our [BoC preview](#), we do expect the Bank to deliver another round of tapering – cutting weekly purchases from CA\$2bn to CA\$1bn – but that is a move that is likely fully priced in. The main market focus will most likely be on the forward-looking language, and here we suspect that the Bank may simply reiterate they expect the first hike in 2H22, hence falling short of the market's aggressive tightening expectations, which are fully pricing in an April hike and see an 80% probability of a March hike. With the USD correction now past us, in our view, we see the balance of risks clearly tilted to the upside for USD/CAD next week. August GDP data released two days after the BoC meeting may provide only a small help to CAD.

## CHF: US Treasury Report in focus

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0670	Neutral	1.0660 - 1.0720	1.0800

- We have no real change from last week's views, which are EUR/CHF is under pressure again and it is not clear why. It has now dropped below the 1.0700 level where we had thought 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 Swiss National Bank 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 has been a surprise. 1.0660 may hold in the week ahead.

## NOK: Time for a breather in EUR/NOK

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.7000	Neutral	9.6200 - 9.7800	9.8000

- NOK has benefitted from a supportive global risk sentiment throughout the week and remained one of the preferred currencies to bet on thanks to its combination of positive exposure to the energy story and a domestic tightening cycle.
- In the week ahead, we think the NOK rally may pause, considering that the krone is already scoring as quite expensive against both the EUR and the USD according to our short-term fair value model. While some other overvalued currencies will face a catalyst for a potential correction next week (like CAD with the BoC meeting), for NOK to give up gains we would likely need to see a deterioration in risk sentiment and/or a drop in oil prices. We think all of these may not be a story for next week and as October unemployment data out of Norway should have limited impact, we expect EUR/NOK to gravitate around 9.70 in the week ahead.

## SEK: Consolidating for now, but Riksbank's reality check looms

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	9.9700	Neutral	9.9300 - 10.0300	10.1000

- The calendar in Sweden includes the Economic tendency survey next week, which generally offers a quite accurate picture of the ongoing domestic dynamics. On the same day (Thursday), September's retail sales will be released. There is, indeed, an open question when it comes to the Swedish markets and SEK: is the market right to disregard the Riksbank's rate projections and price in 2022 tightening?
- We analysed this theme in [this article about our updated view on SEK](#). We think the markets have gone too far with their pricing and we suspect that at the late-November Riksbank meeting policymakers will keep their rate projections unchanged at 0.00% until 2024 with the clear aim of curbing market's hawkish speculations. Before then, we think EUR/SEK may trade mostly sideways. Sweden appears to be in a neutral position against the rising energy prices story, but EUR/SEK has recently moved into undervalued territory, suggesting room for an upside correction in the pair. That said, the catalyst for a correction may not come as early as next week if market sentiment remains broadly upbeat, and given that we could see some inflows into SEK as the 2 November settlement date for the Volvo IPO approaches. EUR/SEK may stay close to the 10.00 level after the big technical break lower.

### Author

#### Chris Turner

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

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

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