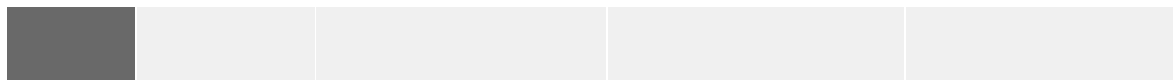


G10 FX Week Ahead: New faces, old challenges

In a week which will see new leaders elected in Germany and Japan, familiar challenges will return to drive market pricing. These include both the US debt ceiling and the unfinished business of Evergrande's debt overhang. Eurozone September CPI may also set the cat amongst the ECB hawks



DXY: Playing it safe with the dollar

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.3700	Mildly Bullish 	92.7000 - 93.6000	93.0000

- The dollar heads into a new week gently on the bid side. To be honest, we were surprised that it did not rally more on a set of hawkish Fed Dots that showed a tightening cycle way above anything priced in money markets. Highlights this week will be a whole host of Fed speakers attending conferences on both sides of the Atlantic. It may be difficult for them to surprise the market now, given that Powell made it reasonably clear that tapering will be announced in November, completed next summer and perhaps making the case for the first Fed hike as early as September 2022. US data this week focuses on consumer confidence, personal income and the September ISM Manufacturing.
- In addition to a supportive Fed back-drop for the dollar, a fragile risk environment could also lend the dollar some support. The Evergrande debt resolution story is far from clear. Chinese authorities' wish for Evergrande to resolve its challenges by itself mean that there may be further twists and turns before a full debt restructuring is announced. And we'll also hear more about the US debt ceiling this week. October 1st is the deadline to approve a stop gap funding bill, though mid-October seems to be the more realistic deadline for when the US Treasury will have to start scaling back activities. In short, risk assets may struggle to find peace this week.

EUR: Who will be the next German chancellor?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1709	Mildly Bearish 	1.1670 - 1.1750	1.1700

- Monday should see the dust start to settle on the German election result, although it could take some time and much horse trading until a new government is formed. The elections have not had much impact on the EUR so far. Pinning a market reaction on the result is tricky, but our latest thoughts suggest a left-wing government could be poorly received by the EUR, while a surprise CDU/FDP coalition could be well received.
- On the macro side, the focus will very much be on prices and what the ECB plans to do about them. Friday sees the release of September Eurozone CPI – expected to rise 3.3% YoY and probably trigger a fresh outcry from the ECB hawks. The week also contains many speeches from the ECB big-hitters, including Lagarde and Lane, who will likely have to hold off the hawks. A more hawkish ECB story may be the best hope for EUR/\$ to be holding above 1.17 by the end of the week.

JPY: Who's the new LDP leader?

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.74	Neutral	109.50 - 111.00	110.00

- September 29th sees the LDP leadership election which, given the LDP dominance in Japanese politics, is effectively the race to become Japan's next PM. There are four candidates in the race, with the frontrunner seen as Taro Kono, the country's vaccination minister. Of the candidates, reports suggest Kono is the furthest away from the Abenomics that triggered the big JPY sell-off seen in 2013/14.
- Given what could be another tricky week for risk assets, we doubt USD/JPY will have the legs to push sustainably above 111.00 – especially with the speculative market still short JPY.

GBP: BoE rate expectations look too hawkish

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3677	Mildly Bearish 	1.3570 - 1.3730	1.3700

- Sterling likely over-discounted the adverse risk environment at the start of the week, and managed to recover losses only after the Bank of England sent some hawkish signals as it announced policy yesterday. In particular, two points appeared to have a more hawkish than expected tone: a) the acknowledgment that some recent developments have strengthened the case for “moderate tightening”; b) the fact that one MPC member (Ramsden) joined Saunders in voting against maintaining the same asset purchase target. As [discussed by our economist here](#), the UK economy is still set to face a number of headwinds this winter, and the MPC still appears divided around the threat that higher inflation is posing. In turn, we think that the current market pricing for a February 15bp rate hike seems too hawkish, and we continue to see no hikes before mid-2022.
- This should, in our view, limit any further upside potential for GBP stemming from rate expectations. Incidentally, we expect GBP to become increasingly sensitive to data as any signs of weakness in the UK economy (and especially in the jobs market) could make investors scale back their views on a February hike. However, this should not be a story for the week ahead, as the UK calendar only includes some housing data and the final read of 2Q GDP. Given GBP's recent increase in sensitivity to global risk aversion, we expect incoming news from China to drive most of the pound moves next week.

AUD: The most exposed to Evergrande

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7240	Mildly Bearish 	0.7170 - 0.7290	0.7200

- AUD followed the swings in sentiment around the Evergrande crisis quite closely, and looks set to end the week around the same level where it started it. Next week, we should see a very similar script, as there are no market-moving data in Australia except for August retail sales numbers. Incidentally, as the Reserve Bank of Australia has officially “frozen” its policy until February 2022, data in the next few weeks may have a somewhat more limited impact on the currency.
- AUD remains, in our view, the most exposed currency in G10 to any spill-over from a potential Evergrande default. And that is not only because Australia is the most China-dependent country in G10, but also as the collapse of a real estate giant would raise further demand concerns in the iron ore market, which may well generate another sell-off in the commodity's price. The only positive factor for AUD now appears to be of a technical nature, as markets are already extensively short the currency. Still, we doubt any substantial short-squeeze will occur in the short term, as domestic and external downside risks continue to pile up for AUD.

NZD: AUD/NZD to break below 1.03 soon

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7003	Mildly Bearish 	0.6930 - 0.7030	0.7100

- China's market turmoil is inevitably hitting the Kiwi dollar that, albeit to a smaller extent than AUD, also has a high beta to the Chinese sentiment. Like in Australia, the data calendar is very quiet in New Zealand next week, and external factors should continue to dominate NZD price action.
- In our view, NZD still looks like a safer bet than AUD in the short-term. As highlighted above, an Evergrande default may hit AUD also through the iron ore channel; while the opposite – Evergrande's situation stabilising, possibly thanks to government support – may see market sentiment improve: here NZD has a more attractive implied yield than AUD and may therefore perform better. We expect a break below 1.0300 in AUD/NZD soon.

CAD: Political risk dissipating

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2696	Mildly Bullish ↗	1.2650 - 1.2800	1.2500

- The loonie has been on a solid appreciation path after Monday's risk sell-off, benefitting both from the rally in oil prices and from some unwinding of political risk premium after Canada's Federal vote. On the latter, while the election sent Canadian politics back to the status-quo (a minority Liberal government), markets appeared to look at the positives: pressures from Trudeau's closest allies – the left-wing NDP – to extend fiscal stimulus are surely endorsing the Bank of Canada's policy normalisation plans. The risks related to this political equilibrium are not absent, and mainly entail stronger opposition to pipeline projects and likely higher taxation to banks. Those, however, are factors that may emerge only later along the way.
- Next week, Canada sees the release of July's GDP numbers. Growth has been the missing piece in an otherwise very robust data-flow for CAD, as a surprise 2Q contraction in activity was the main reason for the Bank of Canada to pause tapering. Still, even if we see a below-consensus GDP read, the very encouraging signals coming from the jobs market and higher inflation should remain enough to convince the BoC to start tapering again in October. We think CAD may stay among the best performers within the pro-cyclical space next week, although its fate remains very much tied to developments in the Evergrande saga.

CHF: Same old SNB, but how much FX did they buy in 2Q?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0835	Neutral	1.0780 - 1.0900	1.0900

- EUR/CHF is steady after a quarterly Swiss National Bank meeting that was another non-event for FX markets. Suffice to say, the SNB slightly cut growth and raised inflation forecasts, but core policy remains unchanged. It will be one of the last central banks in the world to raise rates.
- Looking ahead, this week sees the SNB release details on its FX intervention in 2Q21. These had dropped to just CHF296m in 1Q. EUR/CHF was naturally bid through most of 2Q meaning that FX intervention will probably be as low – but 3Q will be another matter. We have noticed recently that EUR/CHF turned bid when the ECB hawks piped up. Another high Eurozone CPI figure this week could send EUR/CHF back to 1.09.

NOK: Norges Bank's hawkishness boosts medium-term outlook

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.0800	Mildly Bullish 	10.0400 - 10.1800	10.0500

- The Norges Bank delivered the first rate hike in the G10 space since the start of the pandemic this week. NOK jumped after the announcement, although not simply thanks to the rate hike (which was fully priced in), but mostly due to: a) the announcement that one more hike will likely be delivered in December; b) an upgrade in the longer-term rate-path projections. [As discussed here](#), the prospect of an attractive yield profile implies – in our view – that NOK will emerge as a key G10 outperformer in periods of rising risk appetite.
- Next week, NOK will be back to being driven almost solely by external factors. The domestic calendar sees the release of retail sales, PMIs and unemployment data, although they should have a limited FX impact considering how recently the NB has provided details about its tightening plan. More improvements in risk sentiment may push EUR/NOK to the 10.00 support, although a break below such level seems a bit premature for now.

SEK: Unlikely to benefit from good data

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1400	Mildly Bullish 	10.1200 - 10.2200	10.1500

- The Riksbank meeting on Tuesday came in stark contrast with the hawkish surprises seen in Norway, the US and the UK. Swedish policymakers downplayed the recent rise in inflation, and continued to signal no rate hikes until 2024. As highlighted in our [Riksbank meeting review](#), SEK is facing the opposite situation than its peer NOK, as it retains a positive beta to risk sentiment but is offering a very unattractive carry. We think this suggests SEK will lag other pro-cyclicals in times of improved risk sentiment. That said, EUR/SEK is around 3% overvalued in the medium term (according to our BEER model) and a winter without extra-strict containment measures in Europe should still benefit SEK. In turn, we keep seeing EUR/SEK below 10.00 from 1Q22.
- There are a few data points to monitor in Sweden next week: in particular, retail sales, PMIs and the Economic Tendency Survey. Still, after the Riksbank showed unreactiveness to a stronger data flow, we doubt SEK will be able to draw any significant benefits from good data.

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