

G10 FX Week Ahead: Fed to douse the bond bonfire?

A key question for the week ahead is whether the Fed will step in with some verbal intervention (as the ECB has done) to mitigate the disorderly sell-off in bonds, which has been weighing on risk assets. In such a fragile environment, the USD corrective rally may find some support. Meanwhile, the RBA may need to keep intervening to defend its yield target



Federal Reserve

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USD: As good a week as any for a corrective dollar rally

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.6300	Mildly Bullish 	90.1000 - 91.8000	90.0000

- The orderly sell-off in US Treasuries has recently turned disorderly, begging the question into next week: does the Fed care? The week will see a whole host of Fed speakers, including Fed Chair Powell on Thursday, providing the Fed with an opportunity to slow the Treasury decline by at least starting to express some concern – which has been notably lacking so far. Pouring fuel on the bond bonfire next week might be US February ISM data and the jobs report, where an above consensus 200k increase in the latter looks to be the risk. The week will also see the release of the Fed's Beige Book in preparation for what's turning into a crucial March 17th FOMC meeting.
- The disorderly sell-off in Treasuries has started to ripple across asset classes, hitting equities and finally pressuring some stubbornly tight credit spreads. Market corrections after long, benign periods of risk-taking tend to be short, sharp affairs and until the Fed chooses to verbally intervene in the bond market, we would say risk assets remain vulnerable over the week ahead and the dollar could enjoy a brief corrective rally.

EUR: ECB ready to back up its word with bond action?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2120	Neutral	1.1950 - 1.2150	1.2200

- Unlike the Fed, the ECB has formally powered up verbal intervention to resist the bond sell-off and has strongly hinted at using the flexibility of its bond buying Pandemic Emergency Purchase Programme (PEPP) to resist the move. This very much focuses the attention to the Monday pm release of the ECB's PEPP volumes. Over recent weeks the ECB has scaled up PEPP buying to EUR17bn per week – and this amount at least must be seen on Monday to avoid a further sell-off in European bond markets.
- The week ahead will also see the Eurozone flash CPI for February, expected to rise slightly at the headline level, but ease slightly to +1.2% YoY at the core level. Any upside surprises won't help European debt, nor the ECB's threats that rate cuts are still an option. This all comes at a time when Europe will debate re-opening economies (Germany's Merkel discusses this with state leaders on Wednesday) and we should get a broader perspective on the February PMI readings. As above with the dollar section, a risk asset correction spreading more broadly and violently warns that the coming week could see EUR/\$ trade well under 1.20.

JPY: Equity tipping point could limit USD/JPY upside

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	106.52	Neutral	105.00 - 107.00	105.00

- We have consistently under-estimated the scale of this USD/JPY rally – although the US bond sell-off has seen US real interest rates rise sharply. While we cannot rule out a further rise in US yields, potentially dragging USD/JPY close to 107, it does feel as though we are close to the tipping point that would see some sharp 3-5% corrections in major equity indices. This would start to support the JPY more broadly. Rob Carnell makes the point that while not high by international standards, the BoJ will not be too happy with 10-year JGB yields going well above 0.15% and a suggestion of a G7 statement to calm the bond market sell-off may not be completely out of the question.
- In terms of Japanese data, we do note that the Japanese have been scaling back their foreign bond purchases over recent weeks and as such the weekly data should be monitored. We'll also see January current account data – a big surplus – though this seems to be having no impact on the JPY right now.

GBP: Just bull market correction

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3947	Neutral	1.3800 - 1.4200	1.3800

- While resilient for a while, GBP eventually got a hit from the rising UST yields. With the currency being one of the G10 outperformers and speculative positioning rising in recent weeks, the likely positioning squeeze exaggerated the move (though GBP still did better than most of other G10 currencies during the latest sell off). To us, this is just a bull market correction and our upbeat GBP/USD view remains intact. GBP is to benefit from the idiosyncratic vaccine dividend and the less dovish BoE, while the cautious Fed presiding over the deeply negative front-end US real rates should also contribute to higher GBP/USD.
- On the data front, the big focus will be on the UK budget (Wednesday). We expect the furlough scheme and all the other associated cashflow policies to get extended until June, to mirror the re-opening plan. We don't expect major tax announcement next week, though the Chancellor may signal an intention to raise them next year. Overall, the additional fiscal support to be announced next week should underscore the constructive outlook for GBP for 2Q, with the further fiscal help facilitating the economic rebound and making GBP the outperformer in the G10 FX space.

AUD: RBA's yield battle to continue

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7754	Mildly Bearish 	0.7680 - 0.7810	0.7800

- The Reserve Bank of Australia is in a fully-fledged battle with markets to contain selling pressure on Australian bonds. Today, the Bank announced an unscheduled purchase of AUD3bn worth of 2023 and 2024 bonds, aimed at defending its 3-year 0.10% target. The operation has been successful as Aussie 3-year yields closed the week at 0.117% after having previously spiked to 0.147%.
- With the global bond environment remaining fragile, the risk of markets further testing the RBA's commitment to its yield curve control remains quite high. The Bank is likely set to react fiercely as it did this week to further bonds pressures, and as it announces monetary policy on Tuesday, it may stress its bond buying commitments. Apart from that, the RBA meeting should be a fairly quiet one after the Bank deployed a fresh round of stimulus, and may therefore have limited FX implications. The global bond sell-off should remain the primary driver of AUD/USD next week: more negative spill-over into risk assets may see the pair extending its correction below 0.78.

NZD: Reassessing rate expectations

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7280	Mildly Bearish 	0.7200 - 0.7350	0.7400

- The NZ government changed the RBNZ remit to include housing affordability as one of the objectives of monetary policy. We discussed the implications in greater detail in "New Zealand's central bank is starting to feel the hawkish pressure": we think the RBNZ will feel pressure to normalize policy before other major central banks, and this should ultimately come to the benefit of NZD.
- The calendar in New Zealand is very quiet next week, so NZD/USD will move with global risk dynamics. We continue to see the policy differential as likely to push AUD/NZD lower.

CAD: The most resilient in the \$-bloc

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2677	Neutral	1.2550 - 1.2720	1.2500

- The loonie is confirming its better resilience compared to the likes of AUD and NZD when risk sentiment takes a hit, and this should continue to be the case in the next week. The correction in oil prices has also been quite contained, which should continue to provide support to CAD.
- Data-wise, Canadian GDP numbers for December will be released, giving markets a chance to assess the slump in 4Q20. Still, the impact on CAD should be contained considering the release is quite outdated in light of new vaccine-related developments.

CHF: Swiss activity rebounds, EUR/CHF dip should be limited

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0981	Mildly Bearish 	1.0920 - 1.1050	1.1000

- Having surged above 1.10, some broader weakness in risk assets and some strong Swiss data (4Q GDP and the latest KOF activity indicator) has sent EUR/CHF lower. A rocky week for risk assets could see the move briefly extend close to 1.09, but we would expect buyers to return there. After all we see this as a correction in a 2021 bull run for risk assets and like a 1.15 end year target for this cross.
- The Swiss data calendar sees the Feb PMI (should be strong if KOF is any guide) and Feb CPI, expected at -0.3% YoY. We'll also see the Feb update on Swiss National Bank currency reserves, although we don't think the SNB has been that active this month. Overall, we think speculators are caught with some underwater, long CHF positions and once the market correction has run its course, EUR/CHF will be powering above 1.10 again.

NOK: High volatility and lower equity markets not great for NOK

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.4400	Mildly Bullish 	10.2000 - 10.4920	10.2500

- The meltdown in the global bond market and the eventually spill over into the risk assets unsurprisingly weighed on the high beta NOK. While the rising commodity and oil prices were providing support to the krone, the latest disorderly spike in UST yields more than outweighed the positive commodity effect. Near-term, the high beta low liquid NOK remains one of the most vulnerable G10 currencies but unless we see further disorderly UST sell-off, the pace of the NOK decline should slow while the still positive economic outlook for 2Q should eventually favour NOK.
- The more the NOK declines, the more likely it is that the Norges Bank will bring forward the start of the tightening cycle (as the improving economic outlook, higher commodity prices and weaker NOK all suggest pro-inflationary risks within the NB model). Once the dust settles and UST stabilises (or continue rising but in a more orderly fashion) this will give some support to NOK. With a very quiet week on the Norwegian data front next week, it will be all about the direction of UST yields and its effect on risk assets

SEK: Relatively resilient

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1700	Neutral	10.0400 - 10.2370	10.1000

- Despite the challenging global environment, EUR/SEK continues to be relatively well behaved, trading firmly around the 10.10 gravity line and with so far a very limited overshoot above this level. We expect more of the same next week, with EUR/SEK trading around the 10.10 level and be materially less vulnerable than the higher beta NOK
- The prime EUR/SEK driver next week will continue to be the general risk environment (determined by the direction of UST yields) and the domestic data should continue playing the second fiddle. We don't expect Feb PMI Manufacturing and Services (Monday and Tuesday respectively) to have a much effect on the krona.

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