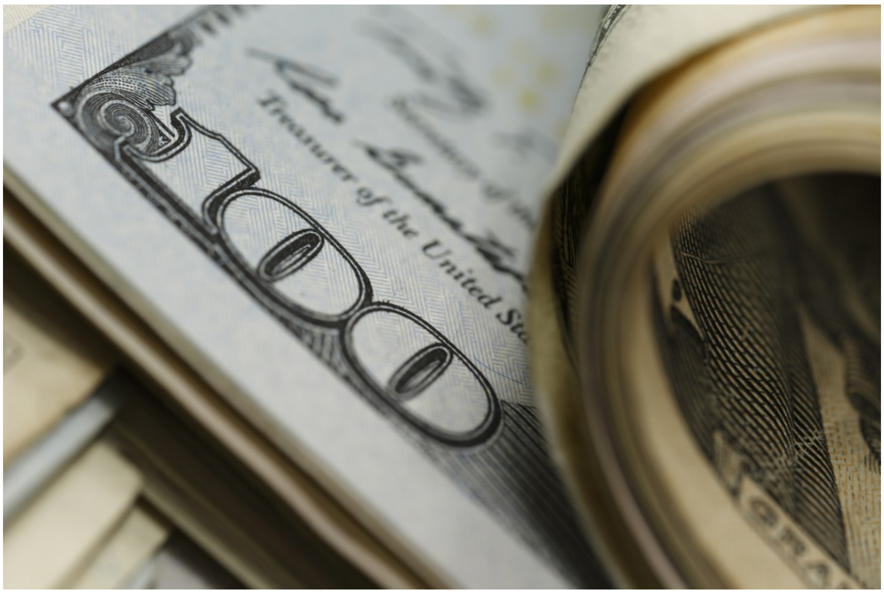
# G10 FX Week Ahead: Go with the flow

After moving to new cycle highs, the dollar may remain supported in the week ahead as markets flirt with the idea of a 50bp March Fed hike. More USD strength may be mostly against low-yielders, with the ECB meeting unlikely to help the euro. Some risk sentiment stabilisation may help pro-cyclicals and AUD might benefit from the RBA cutting asset purchases




Source: iStock

## DXY: Dollar can hold on to its gains

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| DXY | 97.3600 | Mildly Bullish | 97.0000 - 97.8000 | 98.0000 |

- Fed hawkishness has sent the dollar to new cycle highs and we suspect that it can hold onto its gains. The week ahead is a very busy one in the US, where we see ISM surveys and the January jobs reports. For the January NFP, consensus sits reasonably low in the +150-250k range, following a weak +199k reading in December. 1Q22 will not be the best period for US growth (GDP may even contract) yet the Fed looks firmly set on its tightening course and that is key for the dollar. On the subject of the Fed, we will hear from Fed governor nominees, Raskin, Cook and Jefferson, on Wednesday.
- In terms of the overall risk environment, there is some very tentative calm emerging in eastern Europe where further dialogue looks to be pursued over coming weeks. There will also be focus on President Biden meeting Qatari leaders in order to secure extra LNG for Europe, should it be required. Any significant drop in gas prices could be considered better news for European growth prospects. Elsewhere, Chinese markets are closed for the Lunar New Year holidays.

## EUR: ECB offers little support

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/USD | 1.1148 | Mildly Bearish | 1.1040 - 1.1200 | 1.1000 |

- The jump in US short-dated rates on a hawkish Fed has sent EUR/USD to new cycle lows. It looks just a matter of time before 1.10 is tested. Ahead of Thursday's ECB meeting, we'll get to see 4Q Eurozone GDP data, the January CPI reading and some final PMI figures. German GDP missed badly at -0.7% QoQ, but France and Spain surprised on the upside. Consensus expects +0.4% QoQ for the Eurozone figure. Eurozone CPI is expected to turn the corner in January at 4.3% YoY as some base effects drop out. Clearer indications that inflation peaked at 5% in December will hardly push the ECB into a more aggressive stance.
- As to Thursday's ECB meeting, there seems no hurry to alter the current watchful stance even though the idea of inflation being transitory has been quietly parked. With the ECB providing no support for short-dated Eurozone interest rates, EUR/USD will remain at the mercy of the re-priced Fed tightening cycle.

## JPY: No concern from Tokyo

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/JPY | 115.47 | Mildly Bullish | 115.00 - 116.50 | 117.00 |

- Buried amongst the Fed headlines over the last week were some interesting comments from BoJ Governor Kuroda. He downplayed any concern over JPY weakness, saying that a little JPY weakness was good for the economy and that commodity prices, not JPY weakness, was more relevant for inflation. Clearly there is no panic in Tokyo over USD/JPY back near 116. And we suspect that it would take a fast move to 120 to trigger a little more concern.
- We know that the JPY has the highest negative correlation with global equity markets. But were some stability to emerge in equities, and US 10-year yields to drive up to the 2.00/2.25% area as we suspect, USD/JPY could start to motor on the upside. As for other currencies, expect the JPY to be interested in the big energy meetings this week, including OPEC+. Brent pushing towards $90/bl – and coal prices rising too – are negative for Japan's terms of trade and the JPY.

## GBP: 25bp hike to keep GBP supported

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| GBP/USD | 1.3410 | Neutral | 1.3300 - 1.3520 | 1.3400 |

- Money markets are very close to pricing a 25bp BoE rate hike at Thursday's meeting. Presumably the inflation forecast will be revised a lot higher and the market will be interested in reading whether the BoE still feels CPI will be above the 2% target in 2-3 years' time – even with all the tightening priced in. It looks like the BoE terminal rate is priced somewhere near the 1.5% area in 2023.
- With so much uncertainty about gas prices now and a key focus on putting a lid on inflation, we suspect the BoE is quite happy with GBP strength right now. We favour EUR/GBP edging a little lower to 0.8300 this week, which may help Cable to ride out a stronger dollar in a 1.33-1.35 range.

## AUD: RBA to trigger short-squeeze?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| AUD/USD | 0.6990 | Mildly Bullish | 0.6960 - 0.7100 | 0.7100 |

- The Reserve Bank of Australia announces monetary policy next week, and we can reasonably expect another step in the direction of policy normalisation. As discussed in our RBA meeting preview, the Bank is facing pressure to turn more hawkish from three fronts: 1) Data, as jobs markets tightened and inflation rose in 4Q; 2) markets, that are pricing in an aggressive 115bp of tightening in the next 12 months; 3) other central banks, in particular the Fed and the BoC, which have signalled they will start hiking in March. Wage growth appears to be the missing ingredient to kickstart the tightening cycle in Australia, and for now the RBA may simply halve (rather than end altogether) asset purchases, gearing up for a hike in the summer. A decision to terminate purchases would likely be read as a strong hawkish signal.
- We think the balance of risks is skewed to the upside for AUD next week, as markets may see a hawkish turn by the RBA as a chance to trim their overstretched net-short positions on AUD/USD. Still, with a lot of hikes already priced into the AUD curve and the current low appetite for high-beta currencies/high appetite for USD, a rebound in AUD/USD may fall short of the 0.7100 mark.

## NZD: Jobs data could fuel 50bp hike speculation

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| NZD/USD | 0.6560 | Mildly Bullish | 0.6520 - 0.6640 | 0.6800 |

- NZD has been hit very hard from the adverse risk environment and dollar strength, but is one of those currencies that could look at a faster recovery in our, thanks to strong fundamentals.
- Inflation neared 6% in 4Q, calling for fast RBNZ action, and signs that the jobs market has remained quite tight in the 4Q numbers published this next week may allow markets to speculate that the next rate hike (on 23 February) will be a 50bp one. Unlike AUD, NZD can indeed count on a solid prospect of domestic monetary tightening, which means that at least from a rate differential point of view, NZD/USD appears quite undervalued. We could see a move back to 0.66/0.67.

## CAD: Unlikely to emerge as underperformer

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/CAD | 1.2760 | Neutral | 1.2680 - 1.2820 | 1.2600 |

The Bank of Canada did not hike as we expected this week, but provided a very strong signal that the tightening cycle will begin in March. Expect a similar kind of speculation around a possible 50bp hike in Canada than the one in the US, which should offer some floor to CAD in the crosses.
Next week, the focus will be on January jobs data in Canada, a chance to measure the impact of Omicron restrictions in the country. Signs of resilience and more wage growth pressure could fuel speculation around a 50bp March hike and support CAD. We expect USD/CAD to stabilise around current levels with more USD strength that should mostly be channelled through weaker low-yielders.

## CHF: Caught between the East and the West

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/CHF | 1.0380 | Neutral | 1.0350 - 1.0420 | 1.0400 |

- EUR/CHF bounced very sharply off 1.0300 on Monday – SNB? – but as we have all discovered over recent years, such rallies typically do not last. And EUR/CHF remains vulnerable after the December Swiss National Bank meeting where it said that is was more interested in the real CHF than the nominal. In short that means EUR/CHF can fall further – probably closer to 1.00 – before the SNB intervenes more heavily.
- As a low-yielder, CHF should be vulnerable to the hawkish Fed. Yet geo-political concerns in the East, politics in Europe and a dovish ECB all leave EUR/CHF wallowing near the lows. A sea-change looks unlikely soon.

### NOK: Running on oil's resilience

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/NOK | 10.0000 | Mildly Bearish ↘ | 9.9000 - 10.0500 | 9.9000 |

- NOK has been the best performing currency in G10 after the dollar last week. This appears to be all due to the strong performance of oil prices, which insulated the krone from external vows in risk sentiment and geopolitics.
- Next week, the calendar is very light in Norway, and we expect a combination of weaker EUR and a recovery in pro-cyclical currencies to push EUR/NOK back towards the 9.90 mid-January low.

### SEK: Any rebound should be gradual

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/SEK | 10.5300 | Mildly Bearish ↘ | 10.4300 - 10.5800 | 10.3500 |

- SEK's combination of low yields and high exposure to global risk sentiment kept it in a very uneasy spot as rate differentials widened and equities stayed vulnerable this week. Incidentally, the krona was likely played as a proxy bearish trade for geopolitical tensions in Russia, and – unlike NOK – it could not count on the coverage from oil prices.
- Turning the tide should be a slow process for SEK, as latest data showed that: a) CPIF inflation expectations have remained quite anchored around 2%; b) we should see a quite significant slowdown in the recovery in January (as indicated by the Economic Tendency index). This is offering reasons to the Riksbank to keep their transition to a more hawkish stance quite gradual. Next week, we'll keep an eye on wages data and PMIs, both unlikely to move the currency much. We could see some stabilisation or mild pull-back below 10.50 in EUR/SEK, whose rally appears to be now a bit overstretched.

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