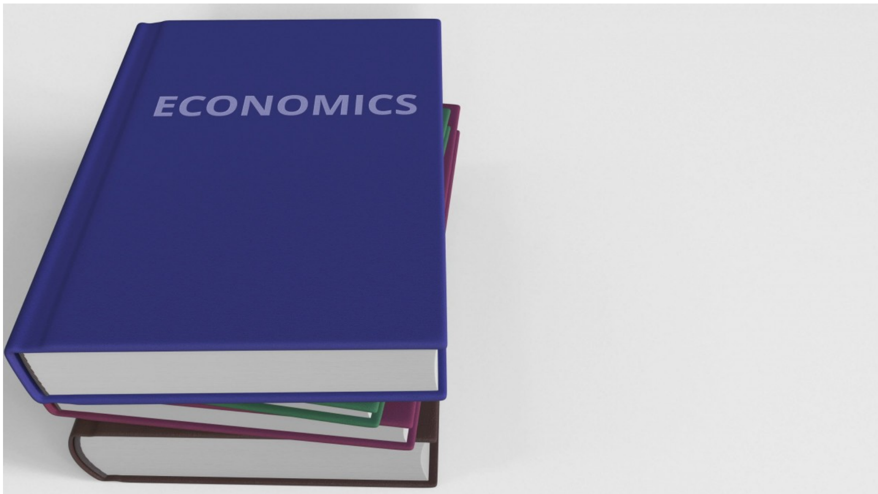
G10 FX Week Ahead: Back to the textbook

After stock volatility and retail trading volumes took centre stage this week, we may see markets' focus shift back to more "textbook" drivers in the next few days, as some key data in the US (payrolls) and in the EZ (GDP and inflation) are released. Elsewhere, the BoE should steer away from negative rates. We expect to see some consolidation in most G10 pairs



USD: Looking beyond the retail trading turmoil

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.5420	Neutral	90.1000 - 90.8000	90.0000

- The dollar has had a strong week versus most peers as a choppy risk environment revamped safe-haven demand for the greenback. That said, the pause in the dollar decline seen during January has not been accompanied – in our view – by a weakening of the key arguments in favour of a medium-term bearish view. The Fed reiteration of its "lower for longer" stance leaves the USD real-rate profile as firmly unsupportive for the currency, and we are inclined to think a resumption of a stable risk rally looks likely in the next months. An unusual driver of risk appetite in the past few days has been the retail-trading-induced high volatility in some stocks and the following trading restrictions by online platform Robinhood. That surely remains one thread to follow, and might keep investors jittery for a little longer, suggesting fresh defensive dollar positions may not be unwound just yet.
- That said, next week we could actually see market's focus shift back to more "textbook" fundamentals as the first bunch of hard data for 2021 is released. The January jobs report will be the highlight of the week and we expect a +100k read, which is slightly above consensus, but unlikely to generate much market excitement. What could instead drive a more tangible market impact is any development on the US fiscal stimulus front, as President Biden will attempt to talk some Republican lawmakers (both in the House and the Senate) into supporting his $1.9tn plan given a razor thin majority has cast doubts over his ability to push the bill through Congress. All in all, we could be looking at some stabilization in the dollar next week, although the balance of risks beyond the short-term remains tilted to the downside, in our view.

EUR: Helped by Eurozone's moderate fall in activity

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2138	Neutral	1.2090 - 1.2200	1.2200

- EUR/USD has held above the 1.2100 level for most of the week, showing further signs of resilience to dollar-buying pressures and unencouraging contagion data in Europe. Surely helping EUR momentum today was the above consensus reads in France, Germany and Spain's 4Q GDP, which suggested the economic impact of the second Covid-19 wave was less pronounced than the first one. On the back of these data, our economists expect the eurozone to have contracted by less than 1% in 4Q.
- That may not be the only piece of data providing some support to the eurozone economic sentiment in the week ahead, as January preliminary inflation numbers are set to rise thanks to a German VAT increase and higher energy prices. While the dollar may fail to show signs of weakness, we see no reasons for the euro to lose its resilience. The Italian political developments (that we discuss in greater detail in the CHF section below) should remain a marginal story for the EUR as the risk of early elections still appears low.

JPY: Unable to cash in on risk-off waves

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	104.70	Mildly Bullish	104.30 - 105.60	103.00

- Despite the rising risk aversion, the yen is the worst performing currency in G10 this week. Interestingly, the one-week risk reversal on USD/JPY has risen to its highest levels since early 2017, indicating a sharp rise in the demand for calls on the pair. These dynamics are confirming the recent indications that the yen is playing a secondary role to the dollar when it comes to safe-haven bets, with a highly skewed net-long positioning in the yen (the dollar stands on the complete opposite side) possibly contributing to the inability of JPY to build momentum.
- Ultimately, however, it's all boils down to the yen's strong inverse correlation with US Treasury yields, where another UST sell-off saw 10Y yields rise back to the 1.10% mark. Our rates team is not expecting yields to edge back down and actually see the 10Y move into the 1.15-1.20% range next week. That may prompt a break in USD/JPY above 105.00 in the coming days.

GBP: Reaping the benefits of the fast vaccination process

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3746	Mildly Bullish	1.3600 - 1.3900	1.3600

- Sterling continues to reap the benefits of the fast vaccination process which puts it ahead of its major peers. With the currency being undervalued based on our medium-term BEER fair value model (around 7% against both USD and EUR), the valuation gap should continue closing throughout the year and GBP/USD is set to continue gradually appreciating (above GBP/USD 1.50 by the year-end), in great part helped by the eventual re-strengthening of EUR/USD.
- The big focus next week is on the BoE meeting (Thursday). We expect no change in the policy rate and no clear signal at negative rates (which we now see as even less likely than earlier in the year given the relatively fast vaccination process in the UK). Although the BoE may formally lower its estimate of the lower bound to below zero next week, we don't expect policymakers to hint that negative rates are imminent (particularly if the UK economy is set to start recovering from 2Q onwards), in turn having a limited impact on GBP.

AUD: The RBA to face a Fed-like dilemma

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7657	Neutral	0.7610 - 0.7740	0.7700

- The Reserve Bank of Australia meets next week and will face a similar dilemma to the one faced by the Fed this week: how to make an unarguably improved outlook coexist with its ultra-dovish stance. The Bank will release new forecasts and there is little doubt that those will take into account the improved unemployment and inflation pictures, but we think the rhetoric will remain cautious and firmly on the dovish side.
- As usual, currency comments will be particularly in focus, although we would be surprised to see the RBA change its stance on the AUD at this point: the recent rise in Australia's terms of trade makes it hard to argue that the currency is materially overvalued. We could see the AUD react positively to the rate announcement on the back of upgraded forecasts, which might spark some speculation of earlier-than-expected tightening (even if the policy message remains dovish). Still, the uneven risk environment may keep AUD/USD gains capped.

NZD: The surprising outperformer

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7192	Neutral	0.7140 - 0.7260	0.7200

- The Kiwi dollar is up against the USD in the week, with most gains coming today despite global equities are taking another hit. Part of the NZD rally might be due to some investors moving their risk-on positions into NZD from AUD after Germany cast some doubts on the efficacy of the AstraZeneca vaccine, which makes a big part of Australia's orders for its mass vaccination scheme.
- In order to keep the NZD momentum going, the NZ 4Q jobs report will likely have to show some better-than-expected numbers. Consensus is expecting the unemployment rate to have moved up from 5.3% to 5.6%, which would still leave NZ in a relatively safe spot when it comes to the pandemic impact on employment. Anyway, we may see the NZD outperformance vs AUD to fade in the coming days given the scarcity of fundamentals supporting it.

CAD: More data surprises?

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2782	Neutral	1.2700 - 1.2830	1.2700

- The data-flow in Canada has continued to surprise on the positive side as the monthly GDP numbers for November showed a 0.7% increase, with the YoY slump coming at a moderate -2.8% compared to the consensus -3.2%. USD/CAD is back below 1.28 – although that's mostly due to some dollar weakness today – and the pair may find some stabilization next week as the jobs market data come into focus.
- Canadian employment numbers have generally outperformed (in relative terms) the US ones in the recovery, and another surprisingly good read may help CAD towards the end of the week. Before that, external factors will be the key drivers: first, any developments in the US fiscal stimulus talks (considering Canada is massively exposed to the recovery in US demand); second, any improvements on the OPEC compliance picture as a result of the cartel's members meeting on Wednesday.

CHF: Chances of a technocrat-led government in Italy rising

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0800	Neutral	1.0760 - 1.0830	1.0800

- Italian politics is set to be in focus in the coming days as a number of parties make the final rush to find a way out of the government crisis. Still, this has become more and more of a side story for markets, and the very contained impact on asset prices (the BTP-Bund spread is back at 115bp) is a testament of this.
- The latest developments have raised the chances of a national unity government led by a technocrat prime minister, as opposed to a new Conte-led cabinet. The President of the Republic should decide on whether to give another mandate to Conte early next week. Both options should have a neutral/mildly positive impact on the market. As highlighted in recent weeks, the only scenario that would materially move the market is early elections, which continue to be ruled out by the majority parties. EUR/CHF should therefore be only marginally touched by upcoming developments in Italy. Looking at domestic drivers, keep an eye on Switzerland's slew of data next week: December retail sales, January PMI and finally the SNB FX reserves figures for January on Friday.

NOK: The days of profound swings

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.3420	Mildly Bullish	10.2000 - 10.4380	10.2500

- EUR/NOK swings continue to be profound (particularly in contrast to the fairly well behaved EUR/SEK) as the high beta, low liquid NOK feels the heat of equity market volatility and the dollar consolidation. Although vulnerable in the short-term (EUR/NOK briefly broke above the 50-day moving average resistance of 10.4939 but is now comfortably consolidating well below this level), the NOK outlook for the rest of year remains positive as the currency should benefit from the most hawkish central bank in the G10 FX space (with Norges Bank currently forecasting the first hike for 1H22).
- The NOK price action next week should be purely about the global risk environment, with risks skewed to modestly higher EUR/NOK given the ongoing volatility in stock markets. Domestically, it is a very quiet week on the Norwegian data front, with the Dec Industrial Production (Friday) unlikely to exert a material influence over NOK.

SEK: Remaining resilient

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1110	Neutral	10.0200 - 10.1700	10.1000

- EUR/SEK has been weathering the recent market volatility fairly well and the cross continues to hover around its 10.10 gravity line. Next week should offer a similar picture, suggesting a resilient SEK vs EUR during the risk off days, but limited scope for a pronounced EUR/SEK decline until the Swedish and eurozone economic outlook brightens (which is more of a story for the second quarter of this year rather than the upcoming weeks). EUR/SEK to remain within its tight trading range of 10.02-10.17 next week.
- Domestically, the focus will be on the Jan Manufacturing PMIs, 4Q20 GDP (both on Monday) and Dec Industrial production (Friday). None of these data points should have a meaningful impact on SEK. With the Covid related uncertainty, the point of the economic recovery being delayed and inflation well below the target (and expected to remain below 2% throughout the year), Riksbank is unlikely to lead on the policy normalisation front among the central banks in the G10 FX space this year and next.

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