G10 FX Week Ahead: Rock around the clock

It's going to be a very hectic week in markets, with US-China tensions the key driver while a number of central banks meet. The ECB will, in our view, top-up its PEPP and - in tandem with revamped hopes for EU coordinated stimulus - add steam to the EUR rally, as low-yielders may keep outpacing the USD. Elsewhere, we expect no changes in the RBA and BoC policy

USD: One step forward, two steps back

	Spot	Week ahead bias	Range next week	1 month target
DXY	98.1700	Mildly Bearish ↘	97.8000 - 99.0000	97.0000

- The top-side break out in EUR/USD has driven DXY decisively below 99.00 and sets up a negative DXY tone for the week ahead. The problem here is that US-China tension continues to create a fragile environment for risk – which up until recently has been associated with a stronger dollar. It will be interesting to see whether the dollar continues to perform as well in a risk-off environment or whether the defensive JPY, CHF and perhaps EUR start to perform much better against the dollar. At the heart of this risk story is how hard the White House is prepared to push China in a US election year. Not too hard (maintaining a benign equity environment) would be our view, but let's see.
- The highlight of the US data calendar should be Friday's May NFP jobs report, where we look for another big drop – minus 10mn – and a rise in unemployment to 20%. The May 12th cut-off for the report suggests these figures will not take any re-opening into account. We'll also have May Manufacturing ISM on Monday, where again the rise in supplier delivery times might misleadingly drive a rise in the headline number. Overall, we are on the look-out for a decisive turn lower in the dollar, but US-China trade tension may muddy the water of a clean new trend in FX markets.

EUR: Taking the positives out of PEPP

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1126	Mildly Bullish ↗	1.1020 - 1.1220	1.1200

- The EUR/USD break-out has been triggered by a modest re-pricing of European political risk, with EUR/USD effectively playing catch-up with some other FX rallies against the dollar. An EU summit on June 18/19 will shed more light on the EC's proposal for financial burden sharing, but we suspect the EUR can stay slightly bid into that. It is within this context that a big top-up to the Pandemic Emergency Purchase Programme at Thursday's ECB meeting – we look for a top-up of EUR500bn – will be announced. Good for European risk should be good for the EUR in the current environment.
- Away from the ECB, we'll also see macro updates such as German industrial production for April – presumably very negative – before somewhat of a bounce-back occurs in May. Because of the uncertain risk environment, we probably have greater confidence in EUR out-performance against the commodity bloc (e.g. EUR/AUD to 1.70) than the dollar per se and we will also be watching whether USD/CNH topside risk is contained near 7.20.

JPY: Where did the volatility go?

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	107.68	Mildly Bearish ↘	106.80 - 108.20	106.00

- USD/JPY's trading range continues to shrink as evidenced by 1 month actual and implied volatility converging on the 5% area, versus 15-20% levels seen in late March. There is no sign of an imminent break-out from the 106-108 range. We do get a sense that the USD/JPY correlation with equities is dropping slightly and we are on guard for the emergence of a 'sell US' bias in markets, which could see the USD/JPY correlation with S&P 500 flipping from positive to negative.
- The Japanese calendar is light this week and instead USD/JPY will probably be driven by US-China trade tension. Japan will also keep a close on the first of the Asian trade data for May – which Korea releases on Monday.

GBP: Brexit talk to dominate

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2376	Neutral	1.2250 - 1.2425	1.2100

- GBP's path through the week ahead will be guided by the next round of Brexit talks between the UK and EU authorities. These start on Tuesday and should conclude with a press conference on Friday. Chief European negotiator, Michel Barnier, has positioned these talks as make or break and the mood music going into them certainly suggests little room for optimism. Little progress has been priced into GBP already, but a conclusion on Friday that an extension (by end June) to the transition agreement was unlikely could see EUR/GBP press 0.9100 and Cable lag in a more supportive EUR/USD environment.
- The UK calendar sees the final manufacturing PMI on Monday and then the final services PMI on Wednesday. Sterling money market futures remain close to their highs, suggesting expectations of negative GBP interest rates are not abating and probably won't at all should failed Brexit negotiations this week point to a cliff-edge departure at the end of the year.

AUD: RBA, GDP and, above all, China

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.6639	Mildly Bearish ↘	0.6500 - 0.6750	0.6400

- Heading into a week with plenty of releases/events in Australia, the AUD is once again proving extremely resilient to geopolitical turmoil and the risks of Chinese retaliatory measures. Speculation that China is planning to impose an import ban on Australian coal is still waiting for some kind of confirmation: the actual will to hit Australian exports may well be a function of how US-China tensions evolve after today's speech by Trump.
- These diplomatic/trade developments will be the major driver of AUD next week, but domestic inputs won't be lacking. The RBA will announce monetary policy on Tuesday. The Bank appears quite in the right place when it comes to monetary policy, with the slower pace of asset purchases broadly consistent with improved market conditions and the end of the lockdown. Governor Lowe should, therefore, keep the monetary settings as they are, acknowledge that the outlook is less grim than previously thought, but also reiterate the RBA's commitment to provide stimulus if needed. Tensions with China have just added some extra uncertainty that suggests caution in offering any hawkish hint. Overall, we expect a balanced impact on AUD. Growth data will also be watched: we expect Australian activity to have contracted by 0.6% QoQ in Q1, which is slightly more pessimistic than consensus. The release should, however, have a quite limited impact as it provides little information on the economic implications of restrictive measures (which were implemented only in late March in Australia).

NZD: Lacking an idiosyncratic driver

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6199	Mildly Bearish ↘	0.6080 - 0.6300	0.5900

- The Kiwi dollar is facing a big deal of downside risk due to NZ strong ties to China if Sino-American relationships continue to deteriorate. At the same time, NZD is lacking a key idiosyncratic driver. The RBNZ reduced the amount of asset bought for a second straight week, but the Bank continues to keep the prospect of negative rates on the table.
- On the crosses, NZD looks less vulnerable than AUD to trade tensions as New Zealand is not directly involved in the diplomatic spat. We expect AUD/NZD to soon pressure the 1.06 floor.

CAD: Macklem may opt for a quiet debut

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3786	Mildly Bullish	1.3650 - 1.4050	1.4000

- The Bank of Canada officially changes its Governor during Wednesday's meeting. Poloz managed to calm markets and provide adequate stimulus to the economy (which shrank 8.2% in 1Q) through a qualitative and quantitative vast QE. Despite a more optimistic outlook compared to the last BoC meeting, new Governor Tiff Macklem may well aim at a smooth tradition and refrain from providing indications that there is any plan to reduce the current degree of stimulus. We expect little surprises from the BoC meeting and the impact on CAD to be relatively short-lived.
- CAD is inevitably getting caught in the US-China crossfire as risk sentiment wobbles, but being Canada more protected from the fall-out of a new trade war compared to Australia and New Zealand, CAD still looks a safer bet in the dollar bloc. Oil will, however, be a key determinant again. As we head into the 9 June OPEC meeting the crude market is retaining a fairly optimistic view as Russia and Saudi Arabia appear to be taking reconciliatory steps. Apart from US-China tensions, downside risk for oil prices stems from a possible second straight build-up in US crude inventories after this week's surprisingly high figure.

CHF: Short squeeze in EUR/CHF or something more?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0697	Mildly Bullish	1.0680 - 1.0790	1.0600

- What we're undoubtedly seeing in EUR/CHF is a short squeeze, but what is not clear is whether this is a major change in European sentiment sparked by the EC's Next Generation project. A short squeeze itself can probably take us closer to the 1.08 area. However, the ECB's top up to PEPP maybe as much as EUR500bn this week and is a key factor why we think EUR/CHF is not set for a sustained rally – effectively SNB FX intervention is unable to keep pace with aggressive ECB money printing.
- In terms of the local calendar, Wednesday sees the release of 1Q GDP expected at -2% QoQ and -1% YoY. Switzerland should also move further into deflation with the May print seen at -1.3% YoY. A terrible reading for the May KOF leading indicator at 53.2, (lower than in 2008) warns that the SNB will not let down its guard against s a strong CHF.

NOK: Stable oil prices offering some protection

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.7910	Neutral	10.6000 - 11.0000	11.1000

- NOK is the best performing currency this week as the stabilisation in crude prices is allowing the currency to keep recovering the massive losses suffered earlier this year. Oil is set to face a challenging week (as highlighted in the CAD section above) but should it continue to show some resilience, it will allow NOK to remain less vulnerable than other commodity currencies (AUD and NZD in particular) to rising US-China tensions.
- On the domestic side, GDP data for April are set to show a very sharp contraction, but should not stand out particularly given the globally depressed picture. The market impact should be limited. EUR/NOK's recent gentle downtrend may stall this week, as the ECB meeting and revamped expectations on a coordinated fiscal stimulus in the EU may keep EUR bid.

SEK: Still in relatively safe spot

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.4890	Neutral	10.3500 - 10.6500	10.6000

- It will be another fairly busy week on the Swedish calendar with the May PMIs and industrial production data coming out. However, as the Riksbank remains opposed to move interest rates back into negative territory and its QE program has already been expanded, data is again unlikely to have a strong market impact on SEK. The biggest calendar event remains the ECB meeting, where expect an increase in PEPP, that may ultimately benefit the EUR.
- Nonetheless, we expect EUR/SEK to remain around the 10.50 level next week as SEK is the least vulnerable G10 cyclical currency to changes in risk appetite, thanks to a relatively lesser easing bias from the Riksbank compared to other global central banks and no exposure to commodity prices.

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