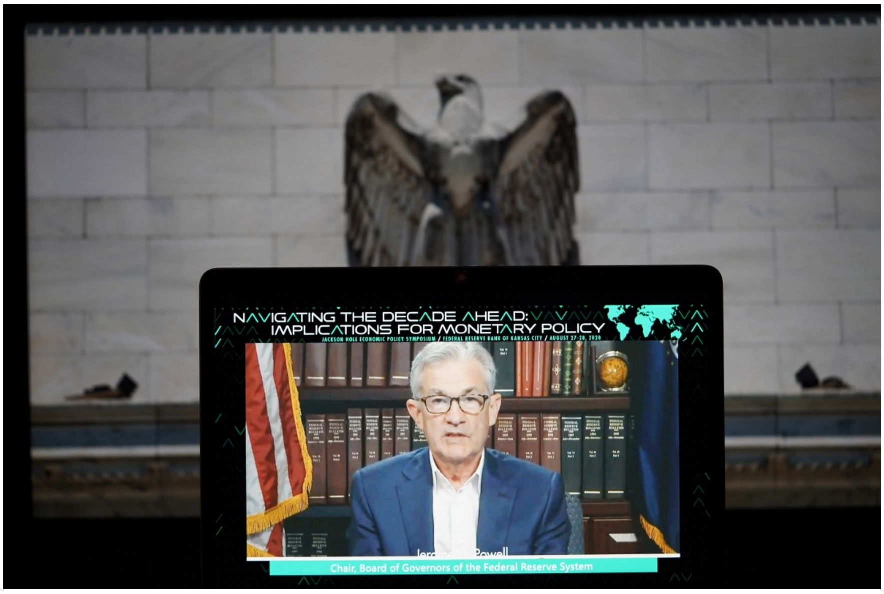
G10 FX Week Ahead: Toes to the fire

The Fed's toes will be held to the fire this week as another round of potentially strong data in the US (ISM and payrolls) may add pressure to start discussing tapering. With some possible fresh weakness in Treasuries on the way, USD might find some respite against the low-yielders. Central bank meetings in the UK and Australia should yield no surprise



Federal Chairman Jerome Powell delivering a speech to the Kansas City Fed's annual Jackson Hole research conference, which is held virtually this year because of the pandemic.

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USD: Fed toes held to the fire this week

	Spot	Week ahead bias	Range next week	1 month target
DXY	91.2460	Mildly Bullish	90.5000 - 91.5500	90.0000

- April saw the dollar suffer an uninterrupted 3% sell-off. May is typically a better month for the dollar in seasonal terms and the coming week may provide an opportunity for a small corrective rally. At the top of the market's agenda is the question over the Fed's commitment to super-dovish policy amidst increasing signs of the US economy gaining momentum. The week should be full of strong US data releases including the April ISM and employment releases – the latter could see in excess of one million jobs added. Would this constitute substantial progress towards the Fed's goals such that tapering should be discussed? 2Q was always going to be an uncomfortable quarter for Fed communications and hot US data in the week ahead pose upside risks to US rates and the dollar.
- It will also be a busy week in EM, where we will see rate meetings in both Brazil and Turkey. Assuming Brazil hikes 75bp and the Turkish central bank remains hawkish – both as expected – the EM environment should remain conducive for carry trades which can limit the dollar's upside. This all assumes, however, that any fresh sell-off in US Treasuries remains orderly.

EUR: Better placed to withstand US yield rise

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2028	Mildly Bearish	1.1980 - 1.2150	1.2200

- While entering a technical recession, 1Q21 Eurozone data was a little better than expected and many signals point to the region rebounding through 2Q. With headline inflation jumping back to 1.6% in April, like the Fed the ECB will face a communications challenge in 2Q. In the week ahead, the market will be looking for insights into the 10 June ECB meeting from a variety of ECB speakers, including the heavy-hitters of Lagarde, Lane and Schnabel. Of particular interest might be remarks from Philip Lane at an OMFIF event on Wednesday, where he'll be talking about the monetary policy strategy review. Any convincing remarks about Average Inflation Targeting (AIT) could briefly weigh on the EUR – as the Fed's AIT has weighed on the dollar.
- Other than that, the focus will be on the recent acceleration of the vaccine roll-outs and lockdowns being unwound – plus any progress on the EU Recovery Fund. The latter could be a positive for the EUR later this quarter if recovery funds do indeed start to be dispersed in July.

JPY: Time for a Japanese re-rating

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.31	Mildly Bullish	108.40 - 109.80	108.00

- USD/JPY remains beholden to the US Treasury story, which on paper means upside risk to USD/JPY in the week ahead. The common argument here is that Japanese investors are attracted by these higher yields and buy Treasuries and the dollar. But we think this argument is full of holes. In fact, USD hedging costs for Japanese investors have this week fallen to the cheapest levels since 2014 and surveys suggest there is very little Japanese appetite for buying unhedged Treasuries in the current market environment.
- Instead we think the Asian growth story could see a little re-rating of the JPY – especially as the currencies of trading partners start to advance. Indeed, foreign buying of Japanese equities seems to be picking up – flows which are less likely to be hedged. The Japanese data calendar is very quiet this week and more interest will be had in the April trade data of key partners such as Korea – assessing whether export trends continue to strengthen despite disruption in the semi-conductor sector.

GBP: The BoE to matter more for sterling than the Scottish elections

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3860	Mildly Bullish	1.3760 - 1.4010	1.4100

- It is a very busy week for GBP, with the focus being on the Scottish elections and the BoE April meeting (both on Thursday). Although the Scottish elections may bring some negative headline news about another Scottish independence referendum, we don't think this should have an overly negative impact on GBP. This is because (a) a referendum could be years away rather than months (even if pro-independence parties win a majority); (b) as we observed with the Brexit referendum, the risk premium started to be built into GBP only six months ahead of the event; and (c) the first Scottish referendum in 2014 did not translate into a material build-up of GBP risk premium.
- As for the BoE April meeting, we should see a series of upgrades to the Bank's forecasts and this encouraging outlook suggests the Bank may announce QE tapering. While this should come as no surprise, on the margin it should be GBP positive, particularly after the tough month of April for sterling. We expect GBP/USD to re-test the 1.40 level.

AUD: RBA to follow Fed's patient approach

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7708	Mildly Bullish	0.7680 - 0.7780	0.7700

- Next week's key event for the Aussie dollar is the RBA rate announcement on Tuesday. The Bank is currently looking at a mixed bag when it comes to key economic indicators: as a sustained recovery in the jobs market has been offset by evidence that inflationary pressures remain modest, after 1Q CPI YoY rose only marginally to 1.1%, still considerably far from the RBA's 2.5% target. On the export side, the Australian terms of trade has risen to new 10-year highs as iron ore prices continue to rise, and possible prospects of a reopening in international travels on the back of faster vaccine roll-out should also keep recovery hopes underpinned.
- The low inflation profile suggests that the Bank will refrain from any hawkish tilt in its statement on Tuesday, and the market impact may be mostly moved by how upbeat the new economic estimates will be. What would likely have more material FX implications is an earlier-than-expected shift in the maturity for the 3-year bond yield target from April 2024 to November 2024: there are currently around 20bp difference between the yields in the two bonds. We are inclined to think the RBA will wait longer to announce a potential decision on the November 2024 bond, and with a broadly unchanged policy message we expect a balance impact on AUD/USD, which should therefore be mostly drive by global risk sentiment and the USD leg next week, with the main idiosyncratic risk likely remaining the increasing tensions between China and Australia.

NZD: Jobs data unlikely to drive big changes in RBNZ rate expectations

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7164	Mildly Bullish	0.7140 - 0.7250	0.7300

- The Kiwi dollar found some support at the 0.7200 level for most of this week, moving largely in line with its closest peer AUD. Focus next week will mostly be on the 1Q jobs report in New Zealand. Considering that the employment failed to show a large drop in 2020, markets are expecting a broad stabilization in the unemployment rate around the current 4.9%. The RBNZ has already sharply revised its unemployment estimates, and barring a major deviation from expectations, we expect the impact on the RBNZ rate expectations and on NZD will be contained.
- Also from a central bank perspective, Governor Adrian Orr will deliver two speeches on Wednesday, with markets likely scanning for any hint of a hawkish tilt given the improved global and domestic conditions. Also, keep an eye on some housing data next week, which may start to provide some indication on whether the Government's measures to curb the housing bubble are having the desired effect.

CAD: The stars have aligned

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2315	Mildly Bearish ↘	1.2170 - 1.2350	1.2300

- CAD was the best performing currency in G10 by a large margin this week. The Fed's reiterated patience and subsequent USD weakness has tended to benefit more those currencies that have central banks leaning towards a more hawkish message, like CAD and NOK, with both also benefitting from supported oil prices.
- What may have driven the strong outperformance of CAD this week were also the indications that the Covid-19 emergency in Canada is starting ease, with the contagion curve flattening. Additionally, Canada has continued to ramp up its vaccine roll-out, now vaccinating as many people as the UK and US every day (on a per-capita basis). This continues to add fuel to the strong recovery story in the Canadian economy, with investors now expecting restrictions to be lifted earlier than previously feared. Next week's jobs data for April may feel the negative impact of those new restrictions across Canada, but in light of the improved virus situation markets may dismiss a set-back in the employment recovery as temporary. After a big rally in CAD, we could see some profit-taking curbing further upside in the short term, but in the medium term the widening CAD-USD rate advantage thanks to the hawkish BoC (and so far unchanged stance by the Fed) along with a still solid domestic recovery narrative in Canada all point at further downside risk for USD/CAD. We target a move below 1.20 by the end of the year.

CHF: Disappointed in EUR/CHF

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0985	Mildly Bullish ↗	1.0960 - 1.1050	1.1100

- We were a little disappointed that the improvement in the European outlook didn't allow EUR/CHF to break higher over the last week. Apart from European and global growth, there is still the Polish mortgage issue hanging over the CHF – though the Polish Supreme Court should rule on this May 11th. Even if it were a negative ruling – potentially prompting Polish banks to wind down CHF borrowing – we would still expect this to take place off-market and not drive the CHF higher.
- Intriguingly Swiss leading indicators have been going through the roof – e.g. the April KOF reading on Friday. This however is making no impression on the SNB – where negative rates and intervention remain 'essential' according to SNB Chair Jordan, nor making any impression on Swiss money markets – which are unmoved. We still very much like EUR/CHF higher later this year.

NOK: No surprises from the Norges Bank

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.9750	Mildly Bearish ↘	9.8500 - 10.1110	10.0000

- The Norges Bank (Thursday) should not surprises much next week. No new forecast will be presented and this suggests a limited impact on NOK. The NB already signalled it will start the tightening cycle later this year, and although we see a non-negligible probability of a hike already coming in September, a new forecast would be needed to justify such a signal from the NB. This is unlikely to come next week. Hence, a limited impact on NOK
- The dovish FOMC brought EUR/NOK below 10.00 and we expect the pair to start stabilising below this level this quarter. The improvement in the EZ economic data and the dovish Fed should keep cyclical currencies in demand, particularly those that have an exposure to commodity prices. Here, NOK ticks the box and it has the added benefit of the tailwind of the tightening NB later this year

SEK: Not deviating too much from its EUR/SEK 10.00 gravity line

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.1580	Neutral	10.0810 - 10.2290	10.0000

- SEK has been lagging its regional peer NOK meaningfully over the past week. Albeit a cyclical currency, its beta to risk is lower vs NOK, it doesn't benefit from higher commodity prices and Riksbank won't provide any helping hand to SEK this year or next. Still, in the wider soft USD environment, SEK should stay supported, and EUR/SEK should remain close to its multi-month 10.10 gravity line. Once the EZ data start surprising on the upside and the global economy shows signs of synchronized recovery (likely in H2), SEK should benefit. We continue to see EUR/SEK below 10.00 in summer.
- It will be a quite week on the date front. April Manufacturing and Services PMIs (Monday and Wednesday respectively) and March Industrial Production (Wednesday) are unlikely to affect SEK too much.

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