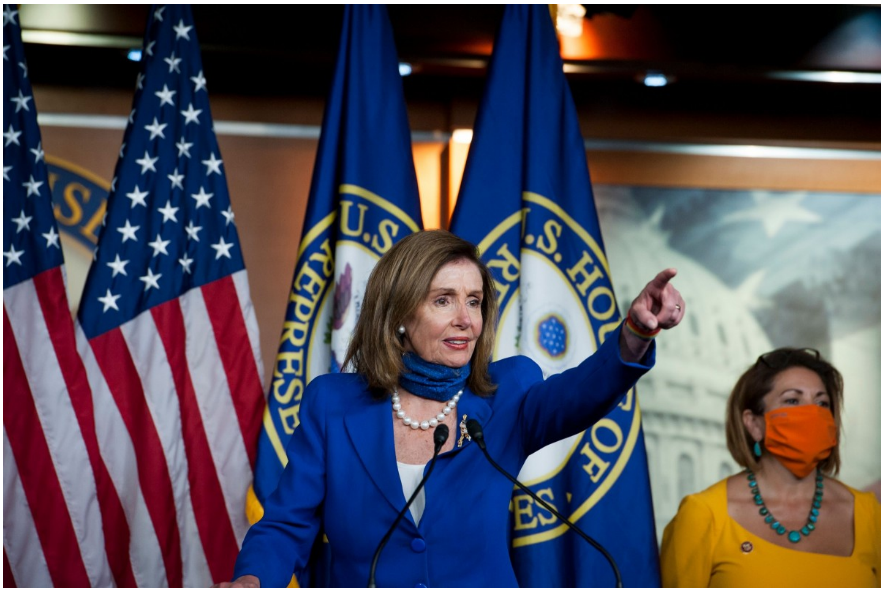
G10 FX Week Ahead: A new dynamic at play

The FX markets head into August showing a new dynamic, as the dollar downtrend appears to be driven by a new virus-related risk premium and other havens are outperforming. Next week, US jobs data may disappoint, but markets will mostly look for a new hope on the US Phase IV stimulus package. Elsewhere, we expect the BoE and RBA to keep their stance unchanged



US politicians, such as House Speaker, Nancy Pelosi, continue to argue about Covid-19 stimulus measures

USD: Jobs and benefits

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.2000	Mildly Bearish	92.5000 - 93.7000	92.0000

- The dollar heads into August under pressure, having seen its largest monthly decline in three years. The nature of the sell-off suggests a different dynamic is at play. This is not the benign dollar decline we had envisaged, but instead, one seemingly being driven on a new risk premium being inserted into US asset markets on the back of a resurgence in US Covid-19 cases and perhaps as well November's presidential elections starting to make their mark – the dollar did not appreciate President Trump's suggestion of delaying the November 3rd election.
- The US week ahead will be about jobs and benefits. On the former, our team believe that an expected July bounce-back in jobs (ADP & NFP) will not be quite as strong as consensus believes. And the non-farm payrolls could actually decline in August. We'll also be focusing on Congress, where the $600 p.m. unemployment benefit boost has now expired and the parties are wrangling over the design of the Phase IV stimulus package. Delays here may upset asset markets, which typically tend to struggle a little more in August. The US data calendar will also see some encouraging ISM numbers, but our US economic team is now more wary about future US lock-downs rather than a modest uptick in business optimism.

EUR: On the road to 1.20

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1820	Mildly Bullish	1.1740 - 1.1910	1.2000

- The speed of the EUR/USD rally has surprised us all and embodies a positive re-assessment of the eurozone project as well as a reconsideration of US risk. Speculators look to have been positioned for the rally, but not for its speed. The need to hold dollars now is less acute, as evidenced by just $107bn being drawn on the Fed's dollar swap lines versus the peak of $450bn in late May. Typically the month of August is slightly friendlier to the dollar, which may generate some consolidation in the 1.17-1.20 range. However, it is a long three months until the US election and with USD hedging costs so cheap, we suspect the dollar will stay on the back foot.
- For the week ahead, we'll see some German real sector data for June (Industrial Production and Factory Goods data), but we suspect the US story will continue to dominate. With fewer fears over dollar liquidity, the big question is whether weaker US data and relatively weaker US equities now actually be dollar negative (rather than positive), as the 'Risk On, Dollar Off' paradigm starts to change.

JPY: The market's new friend

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	105.50	Mildly Bearish	104.40 - 105.90	103.00

- It has been a surprise to see USD/JPY trade under 105 – the move a reminder of new, perceived flaws in the dollar. We assume some of Japan's largest fund managers, including the GPIF, will be using the opportunity to buy US debt securities unhedged – thereby slowing the USD/JPY decline. The move below 105 has also prompted remarks from Japanese authorities over 'vigilance' on these FX moves. Unless, however, we see much more independent JPY strength, e.g. USD/JPY trading at 95, or some disorderly dollar weakness which contributes to a global asset market sell-off, the market will not take threats of FX intervention seriously.
- The Japanese week ahead sees final 1Q GDP, Tokyo July CPI and some final July PMI numbers – nothing to independently move the JPY. Instead, the market may focus on the latest chapter in Softbank's divestment strategy – a reported $32bn sale of its UK ARM tech holding. Divestment proceeds finding their way into the JPY could limit the upside in USD/JPY over coming months.

GBP: Negative rates and their active review

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3160	Neutral	1.3070 - 1.3250	1.3200

- The highlight of GBP's week will be Thursday's Bank of England meeting. Negative Interest Rate Policy (NIRP) is under 'active review' at the BoE, but we think it a little too early for the BoE to make any decisive moves here. We think the BoE will prefer to hold off on the use of NIRP until some clarity emerges on the UK-EU relationship from 2021. Currently money market futures price the bank rate (currently at 0.10%) moving into negative territory early next year. Also, there are no expectations at this meeting for a change in the BoE's £745bn APP target.
- Somewhat surprisingly, GBP has managed to out-perform the resurgent EUR and EUR/GBP is threatening to break under 0.90. Positioning may have played a role here, but we think it is too early to wholeheartedly back GBP and still have a preference for EUR/GBP to trade 0.91/92 as UK-EU trade talks come to a head in October.

AUD: RBA should stay cautious given virus spikes

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7180	Mildly Bearish ↘	0.7100 - 0.7230	0.7000

- The Australian state of Victoria remains in full-emergency mode as the lockdown restrictions are failing to flatten the contagion curve. Now the risk is that even stricter measures will be imposed in the state, which keeps the balance of risks for the already uncertain economic recovery outlook tilted to the downside.
- As the RBA announces monetary policy next week, investors will specifically look at how the Bank will factor in the flare-up in Victoria cases in their monetary policy stance. The most straightforward move could be to simply to reiterate the current accommodative stance and the determination to do more if needed. At this stage, further tapering comments will hardly find any space. Like in the previous meeting, markets will be very sensitive to any currency comments to track any change to the currently very-relaxed stance on AUD strength. With markets likely positioned for such a scenario, the AUD may see a somewhat limited impact from the meeting. The week in Australia is packed with other releases, with trade and retail sales data from June, and the RBA Statement of Monetary Policy later in the week. Markets, however, may look beyond such data given the recent developments in Victoria have risen fresh concerns on the economic outlook, and AUD may only marginally benefit from any data surprise. Choppy sentiment could put some mild pressure on AUD/USD next week.

NZD: Brace for grim employment data

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6650	Mildly Bearish ↘	0.6600 - 0.6700	0.6600

- The key focus next week data-wise will be NZ 2Q jobs numbers. The unemployment rate is expected to have risen to the 5.5% area, but there is a risk of a grimmer read given the very restrictive measures still in place in New Zealand in April and the hospitality sector struggling to recover on falling tourism.
- NZD/USD may struggle to display another leg higher as rising concern around second waves around the world – along with the possibility of US-China tensions re-escalating – could keep sentiment capped. On the crosses, AUD/NZD still appears to have good downside potential given the higher idiosyncratic risks affecting AUD.

CAD: Some help late in the week from labour data

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3420	Neutral	1.3340 - 1.3500	1.3500

- Some better-than-expected GDP data for May paired with stabilising oil prices allowed the lagging CAD to outpace its peers AUD and NZD today, Friday. Still, the downside risks to the loonie remain quite evident as the currency stays dangerously bonded to the dynamics in contagion/lockdowns in the US and crude prices have shown fresh signs of fragility.
- Next week will mostly be about jobs data. Our economics team expects a drop in the unemployment rate from 12.3% to 10.5%, with a 550k net increase in unemployment. Signs of a further recovery in the jobs market should offer CAD some support at the end of the week, but more grim US virus numbers and choppy risk sentiment signal still low chances of a break higher in CAD for the time being

CHF: Sub 0.90 in USD/CHF would be remarkable

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0790	Mildly Bearish ↘	1.0730 - 1.0820	1.0700

- USD/CHF has not spent much time below 0.90 over the last decade – the last occasion being the SNB's exit from the EUR/CHF floor in 2015. A move below 0.90 would be a sign that the dollar is indeed embarking on a meaningful decline. The move may also have some implications for SNB intervention. CHF strength against the USD could see CHF trade-weighted indices push even higher (especially since EUR/CHF hasn't rallied much) and prompt even more intervention (SNB starts buying USD instead of EUR?). A cautious risk tone emerging from the US should also keep the CHF in demand.
- The local calendar sees July CPI, expected at -1.3% YoY, an expected improvement in the July manufacturing PMI and July FX reserve data. A small rise in Swiss FX reserves would not be a surprise. As an aside, the SNB provides the most transparency on FX reserve composition of any central bank in the world. A theme into year-end will probably be central banks cutting benchmarks weights on the dollar and SNB data can provide valuable insights.

SEK: Stabilising

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3010	Neutral	10.2400 - 10.3600	10.4000

- EUR/SEK appears set to find further stabilisation within the 10.20/10.40 range, although SEK is likely set to keep showing more resilience to risk corrections than its G10 peers, in our view.
- Next week's calendar will include some surveys, industrial orders data and the 2Q GDP indicator, with the latter likely showing a very sharp contraction (although possibly less than other European countries). However, this is likely in the price and data may leave SEK unfazed, with the currency possibly finding the upside capped for now, but still resisting to the downside.

NOK: Gauging oil resilience

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.7300	Mildly Bullish	10.7000 - 10.8500	10.6000

- The timing of the OPEC+ resumption of some production is not ideal for oil bulls as new virus hotspots across the world are fiercely re-imposing demand concerns. Next week will likely be pivotal to test the ability of crude prices to withstand more bad news on the virus side.
- NOK is set to move quite firmly in line with oil and sentiment dynamics next week as the calendar in Norway is set to offer no idiosyncratic catalysts to the currency. NOK continues to look more exposed to downside risks than the other Scandinavian currency SEK.

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