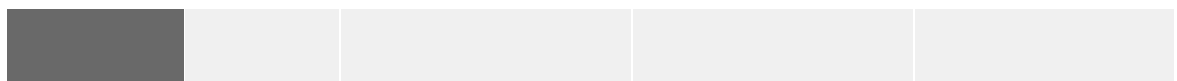


G10 FX Week Ahead: A big week for European politics

With global equities stabilising after a turbulent week, the focus turns back to European politics - with Italy and Brexit on the agenda at a monumental EU summit. EUR and GBP to stay sensitive to headlines. Elsewhere, the US Treasury's FX report will be key as it'll tell us whether the US administration will actually label China a currency manipulator



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EUR: Italy headwinds trump Donald's Fed jawboning

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|------------------|-----------------|----------------|
| EUR/USD | 1.1540 | Mildly Bearish ↘ | 1.1460 - 1.1620 | 1.1500 |

- Despite some stability in emerging markets and President Trump's desire for restraint in Fed tightening, it seems too early to play for a weaker dollar. The US-China trade war shows no signs of slowing and USD/CNH moving towards 7.00 can easily unwind recent recoveries in EM. For this week our team are looking for another round of strong US data (Retail Sales on Monday and Industrial Production on Tuesday), which should keep US rates on the firm side.
- In Europe, the highlight will be the Italian submission of its three-year budget plan and the response from Brussels. Plans for a 1.7% of GDP structural deficit for 2019/20/21 will not be greeted well by the European Commission and presumably will spark a war of words. We struggle to see the Italian government backing down anytime soon and could see the EUR under pressure again. Perhaps the best hope for a EUR/USD recovery over the coming week is a Brexit deal. The EUR has been dragged around by Brexit developments and a deal ahead of the EU leaders' dinner on Wednesday night could provide EUR/USD a brief fillip early in the week.

JPY: Idiosyncratic stock market correction having limited spillover effects

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/JPY | 112.10 | Neutral | 111.70 - 113.20 | 112.00 |

- While USD/JPY did come off its 114.00/50 highs this week - partly as US yields topped out and partly as US stocks corrected - the cross-asset correlations haven't been telling of anything fundamentally untoward. Indeed, we saw in February 2018 that a spike in the VIX index had a limited impact overall on USD/JPY - and there's an air of 'deja vu' when it comes to price action this. We suspect short JPY unwinds have probably been the main reason for the 2 big figure move lower in the pair - and in absence of any sustained stock market sell-off next week, USD/JPY could well stabilise in the 112-113 range.
- The Japanese calendar sees Sep national CPI data (Fri) - with markets looking for the core (ex-food) CPI release to marginally tick up to 1.0% YoY. Although with the BoJ's preferred core-core CPI print still expected to stay rooted at 0.4% YoY, we doubt there'll be much of a reaction in JGB yields or the yen. All of this does, however, precede an important BoJ meeting later in the month - so also watch out for activity data in the week ahead (capacity utilization, industrial production, trade). As our economists have noted, the Japanese economy is not in bad shape.

GBP: Solid UK data + positive Brexit deal sentiment = A big rally (with caveats)

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| GBP/USD | 1.3205 | Bullish ↗ | 1.3120 - 1.3360 | 1.3400 |

- A buoyant pound heads into next week's key October EU summit trading on the sentiment that a Brexit Withdrawal Agreement is almost done. But we wouldn't be surprised if there's some degree of lingering scepticism – not least with the Salzburg disappointment fresh in investors' minds and the seemingly trivial, yet significant, UK political hurdles that still need to be overcome. We think any deal announced would need to stand the following test for GBP to hold onto further gains: (1) the deal is able to command a majority within the UK parliament and (2) the high-level future trade agreement doesn't tie the UK to an obvious hard Brexit trade deal. Any announced exit deal as early as next week that meets the above two tests would see markets all but fully price out the risks of a no-deal Brexit – thus fuelling further bullish GBP/USD momentum towards 1.34-1.35. But if there are still doubts about whether a Brexit deal could get through UK parliament - or no big announcement next week - we could see some profit-taking or a buy-the-rumor, sell-the-fact type of reaction that sees GBP/USD retreat to 1.3050-1.3100. Expect volatility either way with option markets pricing in a significant move (one-week breakevens around 150 pips).
- It's also a big week for UK data releases - with the usual flurry of the labour market, CPI and retail sales reports all due. Our economists note that kicking off a packed week of UK data, we're likely to see another decent wage growth figure on Tuesday, confirming that skill shortages across the economy are pushing employers to raise pay to attract/retain talent. In fact, there's a possibility that headline (ex. bonuses) wage growth nudges up to the symbolic 3% level. Headline CPI could also come in elevated, while retail sales may contract on a monthly basis after a booming summer of consumer activity. The mixed UK data shouldn't really have too much of an overall impact on GBP - with Brexit deal sentiment the key driver. But solid data - coupled with positive Brexit sentiment - could provide a double boost to the pound next week.

AUD: Holding up despite a wave of external negativity

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| AUD/USD | 0.7120 | Neutral | 0.7040 - 0.7240 | 0.7000 |

- While AUD/USD had been flirting with a possible test of the psychological 0.70 level, it appears that investors aren't quite ready to throw the kitchen sink when it comes to chasing the Aussie dollar lower. Arguably, a lot of bad news is already priced in - and on the margin, some stability in the CNY and whispers of US-China trade talks resuming are helping to provide support. What's not is probably the broader sell-off in global stock markets - which is likely to keep high-beta currencies like the AUD in check. While we're slightly surprised not to see a bigger initial move lower in AUD/USD on the back of a shaky few days in global markets - a more pronounced and sustained stock market rout would likely weigh on the AUD. On the flipside, China not being named a currency manipulator by the US Treasury and solid 3Q China GDP (Fri) could be small positives for the AUD.
- The domestic newsflow has been relatively quiet of late - although the week ahead does see the Sep jobs report (Thu) and Oct RBA meeting minutes (Tue). Markets will be looking for back-to-back solid employment growth (prior +40k) to corroborate the RBA's positive outlook on the labour market. The central bank's policy message has been pretty neutral - which is adequately priced into the AUD OIS curve - and Governor Lowe didn't give much away in his recent comments. Indeed, the most interesting headlines that crossed the wires was the RBA chief's endorsement of a strong US dollar - which probably didn't go down to well in the White House (if they were paying attention).

NZD: Positive 3Q CPI surprise could shelve RBNZ rate cut talk

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| NZD/USD | 0.6510 | Neutral | 0.6400 - 0.6600 | 0.6400 |

- Given that the RBNZ's dovish policy bias has been a key factor weighing on the NZD, the 3Q CPI report (early Tue local time) will be an important test of this. NZD OIS markets are still pricing in a small risk of an RBNZ rate cut in 1Q19 (~10% probability) and any positive CPI surprise could dent any lingering dovish sentiment. Market consensus for the headline CPI print is +0.7% QoQ (versus +0.4% prior) - although it's probably worth keeping a closer eye on the RBNZ's sectoral factor inflation print, which is currently at 1.7% YoY (and just shy of the 2.0% inflation target). Still, with business confidence also a key concern for policymakers, we doubt that investors will necessarily chase a hawkish RBNZ story on any solid CPI release next week - at best we see this as a supporting factor for NZD crosses.
- NZD/USD saw a brief halt in its declining trend this week as both US yields and the US dollar ran out of upward steam - while the market had been positioned extremely short the pair. We think the domestic fundamentals are still mixed for the NZD, while the external geopolitical and trade backdrop is also uncertain. This could keep any NZD/USD short squeezes higher fairly shallow in the near-term.

CAD: Busy Canadian data week poses minor risk to BoC tightening expectations

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/CAD | 1.3010 | Neutral | 1.2900 - 1.3100 | 1.2800 |

- It's a busy Canadian data week with CPI (Fri), retail sales (Fri) and the 3Q BoC Business Outlook report (Mon) all due. Our economists expect a flat monthly CPI figure and the rally in oil prices should help keep price levels neutral despite wage growth concerns. But any surprises to the upside or downside shouldn't deter the BoC from hiking later this month (which is 90% priced in) - but the latter may see a slightly negative CAD reaction as doubts creep in. Aug retail sales are expected to come in at +0.4% MoM - which should confirm signs of healthy domestic activity (despite prior NAFTA uncertainties).
- When it comes to oil and CAD, our commodities team note that the lack of pipeline capacity to carry Canadian crude oil to the US or other markets and reduced refining activities at Washington area due to an NG pipeline accident pushed the Western Canada Select crude prices to below US\$20/bbl yesterday (with WTI-WCS spread widening to a record high of above US\$50/bbl). Oil price volatility and external global market forces remain a headwind for CAD and we look for the pair to trade broadly neutral around the 1.30 level in the absence of a risk relief rally.

CHF: Making little sense

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/CHF | 1.1455 | Mildly Bearish  | 1.1400 - 1.1500 | 1.1500 |

- EUR/CHF continues to enjoy its steady recovery from the September low near 1.12 - without a clear catalyst. It's hard to argue that there's any clarity on Italian politics right now and indeed we may well be moving into a messier period where Brussels rejects Rome's expansionary budget. There's a slight chance EUR/CHF could get a lift a Brexit deal gets agreed this week - i.e. European political risk premium narrows a little - but that's rather clutching at straws.
- Instead, it really is not clear why EUR/CHF should be trending higher right now. In fact, interest rate futures curve actually have more tightening priced for the SNB than the ECB in 2019 - despite a more openly dovish SNB. One could always make a case for a fresh bout of SNB FX intervention to weaken the CHF, following the dovish September monetary policy meeting. But it's been hard to discern that activity from the weekly CHF sight deposit data - and speculation of SNB FX intervention is just that, speculation. Until we get a better feel for the key factors driving EUR/CHF right now we'll be forecasting neutral trading ranges.

SEK: Positive CPI surprise doesn't change short-term bearish dynamics

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|---------|-----------------|-------------------|----------------|
| EUR/SEK | 10.3600 | Neutral | 10.3000 - 10.4500 | 10.5000 |

- After a positive Swedish CPI print, EUR/SEK has fallen to the 10.35-10.40 area. But it's a very quiet week in the domestic calendar that could fuel further hawkish Riksbank momentum (unemployment data on Thu being the key macro release). But our economists do note that Swedish house prices are worth keeping an eye on as there are signs that prices may be about to take another leg down this autumn. And 14 October is the deadline for Conservative party leader Ulf Kristersson to propose a government to the Swedish parliament. If he finds himself unable to form a government, or his proposal is voted down, the government formation mandate is likely to pass to Social Democrat leader Stefan Lofven (currently serving as caretaker PM). So far there are few signs that the post-election deadlock is any closer to breaking, so discussions could easily drag on for some time yet.
- Despite the higher-than-expected Sep CPI and the meaningful medium-term SEK undervaluation (10% cheap vs EUR based on our BEER model) we retain bearish view on SEK into the year-end as the resolution fund related decline in interbank rates should weigh on SEK in coming months. We expect EUR/SEK to re-test the 10.70 level this quarter, but given the 50:50 probability of Riksbank hiking already in Dec, we see this area as a potential top now.

NOK: Fluctuating oil prices could see higher short-term FX volatility

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/NOK | 9.4660 | Neutral | 9.4000 - 9.5500 | 9.4500 |

- EUR/NOK has seen some wild swings around the 9.50 mark this week - having moved to an intraday low of 9.4393 earlier in the week before then moving as high as 9.5466 later in the week as oil prices turned lower. The pair, however, should stabilise below 9.50 amid a quiet week ahead in the domestic calendar - with oil price and general risk volatility likely to be the key drivers. We do get second-tier data releases in the form of Sep trade data (Mon), 3Q house prices (Tue) and 3Q industrial confidence (Fri). These are unlikely to be game-changers for NOK.
- Looking ahead, while the Norges Bank surprised with a dovish hike in last month (the disappointment came from the lower than expected interest rate path forecast, which was in fact downgraded) - we think the negative impact of this on NOK was merely a one-off factor. Elevated oil prices, solid domestic economic data and the central bank delivering two additional hikes in 2019 (we still don't rule out three hikes next year) is supportive for NOK.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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