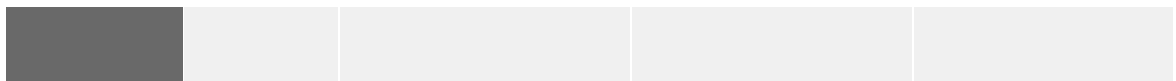


G10 FX Week Ahead: A Fresh Start

Higher US interest rates and some encouraging geo-political news have triggered a large squeeze in short USD positions. USD bears look like they'll have to endure some more pain over the coming week, which should see strong US activity and price data, plus an FOMC. The 200-day m.a. at 1.2010 in EUR/USD will be a key barometer of how far this correction extends



EUR: Another tough week for USD bears

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/USD | 1.2080 | Mildly Bearish  | 1.2010 - 1.2200 | 1.2300 |

- The week ahead poses another major challenge for USD bears given a full US calendar of an FOMC meeting, activity data in the form of ISM and NFP plus a set of price data which should see the core PCE to jump to 2.0% YoY from 1.6%. We really think the rise in short-dated yields and their impact on USD hedging costs are helping to drive this USD short squeeze - and those short USD rates may rise even further if the US Treasury's quarterly refunding announcement (Wednesday) directs more issuance to the short end of the curve.

- From the Eurozone side, the highlight will be the 1Q18 GDP data released on Wednesday. Most expect a slow-down to a pace of 0.4% QoQ from 0.6%, but arguably this is now priced into EUR rates and FX markets. In the same way 3% was a big story in the US Treasury market last week, 1.20 should be as nearly important for the FX market this week - especially with the 200-day m.a. at 1.2010. Strong US data ahead suggests this gets tested.

JPY: When the going gets tough

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/JPY | 109.20 | Neutral | 108.30 - 109.80 | 108.00 |

- Against the backdrop of a short USD squeeze, easing geopolitical tensions (Korea peace deal) and rising US rates, it's easy to see why USD/JPY has climbed back above 109. The risks are that the USD short-term resurgence continues if US data outturns continue to remain constructive - and we could see USD/JPY clear 110 (though ahead of this, it's worth noting that the 50% retrace of the Nov-17 to Mar-18 decline in the pair comes in at 109.65). The JPY's only saving grace would be a surprise uptick in White House political uncertainty (which given its unpredictable nature, can never be ruled out in any given week).
- The Bank of Japan struck a fairly dovish chord as expected - taking out any reference to meeting its 2% inflation target in FY19. While there have been murmurs of potential BoJ normalisation steps early next year - we doubt that markets have been actively chasing this story. After the disappointing Tokyo CPI release, the week ahead focus turns to Japanese activity data - with manufacturing PMI (Tue) and services PMI (Wed). We also get Japanese consumer confidence data (Wed). Some revival of the positive economic activity could provide a buffer to JPY downside.

GBP: Feels a bit too early to throw in the towel

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| GBP/USD | 1.3780 | Neutral | 1.3700 - 1.3940 | 1.4200 |

- After another dismal week for GBP - with the disappointing 1Q UK GDP print all but denting hopes for a May BoE rate hike - there is a temptation to say that this is as good as it gets for the pound. We think it may be too early to throw in the towel on our bullish GBP outlook; one set of data releases do not alter a medium-term outlook, while the forces that have underpinned a more buoyant GBP in 2018 - namely a re-pricing of a structural Brexit risk premium and lower short-term economic uncertainty - still to some degree remains in place.
- GBP/USD's pullback to the 1.3750-1.3800 area is consistent with markets fully pricing out a May BoE rate hike; while we don't think that this is completely dead and buried, we would need to see some bounce back in the April UK PMI readings (manufacturing - Tue; construction - Wed; services - Thu) to keep lingering hopes alive. UK politics in the week ahead sees local elections (Thu); with the ruling Conservatives under pressure, we could see some negative headlines keeping a deflated GBP under wraps. Though unless we see material pressure on PM May to resign - we don't expect the pound to trade significantly lower on this story.

AUD: Breach of the 0.75 level could trigger further downside pain

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| AUD/USD | 0.7550 | Mildly Bearish  | 0.7450 - 0.7660 | 0.7500 |

- The RBA meets this week (Tue) against a mixed backdrop for the domestic economy; the small miss in headline 1Q CPI (0.4% QoQ vs. 0.5% consensus) - and subdued underlying price pressures - will do little to engender any hawkish optimism within the central bank, although consumer and business activity has been slightly more constructive of late. We'll also get the RBA's latest economic projections (SOMP) this month and we expect these to remain broadly unrevised (slight downside risks to what looks like an optimistic GDP profile). Still, an unchanged statement means that the May RBA meeting should be somewhat of a non-event for the AUD.
- Governor Lowe is also due to speak at a separate event following the meeting (Tue) - and may provide greater colour on the balance of risks to the policy outlook. Remember the message of late has been that the next move in the cash rate is more likely to be higher than lower. Any deviation away from this - which seems unlikely - would be slightly AUD negative. On the data front, we'll see manufacturing PMI (Tue) and services PMI, trade data (both Thu). Should the USD remain bid in the short-term, risks are that AUD/USD clears the 0.7500 support - which would expose a potential run down to the 0.73-0.74 area.

NZD: Spotlight on 1Q jobs report given the RBNZ's new dual-mandate

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| NZD/USD | 0.7020 | Neutral | 0.6960 - 0.7150 | 0.7200 |

- The New Zealand 1Q jobs report (Tue) will dominate the domestic agenda in the week ahead - not least with the RBNZ's new dual-mandate now in focus. While employment growth is expected to pick-up to 0.6% QoQ, we note that the unemployment rate at 4.5% still remains some 1% above the level seen in 2008. While the RBNZ have no specific target in mind for "full employment", we suspect policymakers will continue to see room for a further decline in the unemployment rate - which should keep the policy bias fairly neutral in the short-term. Lacklustre wage growth pressures also support the case for this.
- We note that investors have already adjusted to the idea of a neutral RBNZ in 2018, though equally bets for a 1H19 hike are also being tempered a bit. With net long NZD/USD positioning at extreme highs (+45%) in mid-April, we suspect most of the 4.5% decline in the pair since then is due to a sharp positioning adjustment. We would need to see an idiosyncratic positive USD story emerge for a more sustained move lower through 0.70.

CAD: Running out of short-term bullish catalysts

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/CAD | 1.2865 | Neutral | 1.2720 - 1.2950 | 1.2500 |

- Feb GDP data (Tue) will be closely monitored given the Bank of Canada's data-dependent policy approach; consensus is looking for a +0.3% MoM increase following a -0.1% MoM decline in Jan. A positive surprise could rekindle some lost optimism over a May rate hike (currently a 36% probability is priced in), though the market consensus, for now, remains that we won't see a BoC move until 2H18. Indeed, Governor Poloz gave little hopes for anything otherwise with some fairly vague comments on where the end-point of the BoC's tightening cycle lies.
- NAFTA negotiations continue to go back and forth - with this week arguably seeing a step back in proceedings after the US reaffirmed its requirement of a 'sunset clause' in the deal (note Canada and Mexico continue to reject any need for a periodic five-year re-assessment of the trade pact). Along with a consolidation in oil prices, this has partly dented some of the bullish optimism that had driven CAD sharply higher in early April. We look for consolidation in USD/CAD now in the absence of any further negative CAD developments.

CHF: USD hedging costs spooking Swiss investors

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|------------------|-----------------|----------------|
| EUR/CHF | 1.1960 | Mildly Bullish ↗ | 1.1930 - 1.2035 | 1.2100 |

- We think higher USD rates have had some out-sized performance on USD/CHF - especially as Swiss portfolio managers will have probably had to cut USD hedge ratios because of the cost. Last year the SNB had highlighted the increasing amounts of portfolio flows into foreign assets, but the increasingly high hedge ratios on those assets. That's why we suspect high hedge USD hedge ratios aren't viable with hedging costs into CHF well over 3.00%.
- For the week ahead, we'll see Swiss KOF on Monday and then the manufacturing PMI on Wed. There doesn't seem a good reason for any sharper slow-down here. Also, Thursday sees SNB Jordan discuss the 'Vollgeld' initiative. This should serve as a reminder of the populist referendum on June 10th and be slightly CHF negative. If our team are right with strong EZ 1Q GDP on Wed, we could see EUR/CHF sustaining a move through 1.20.

SEK: Not many reasons to be cheerful, apart from Abba

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|---------|------------------|-------------------|----------------|
| EUR/SEK | 10.5000 | Mildly Bullish ↗ | 10.4500 - 10.5500 | 10.5000 |

- SEK remains under pressure after the Riksbank pushed back the first expected hike to December. The market isn't really convinced about December either (a 10bp rate hike priced) and we see the risks of the Riksbank easily pushing back the tightening into 2019. This week sees a relatively light Swedish calendar, although we see the risk that Wednesday's release of PMI data could recover slightly.
- At present, it's not clear where this EUR/SEK rally is going to stop - 10.70? The Riksbank doesn't seem to be too worried by it and we probably need to see a clear calming of protectionist sentiment, plus an improvement with Western relations with Russia - neither of which seems likely - to help turn this SEK bear trend around. Perhaps news that Abba are releasing new music for the first time since 1982 will make a difference!

Norges Banks to stick to hawkish script

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/NOK | 9.6400 | Mildly Bearish  | 9.5800 - 9.7000 | 9.5000 |

- Unlike in Sweden, the market still believes Norges Bank will hike rates this year and Thursday's Norges Bank rate meeting should support this view. Less slack in the economy and higher oil prices should give Norges Bank to continuing discussing a possible rate hike in September. Additionally, this is an interim Norges Bank meeting with no new Monetary Policy Report, thus the slightly hawkish tone of the March meeting should be repeated.
- Firm crude prices ahead of Trump's May 12th decision whether to pull out of the Iran nuclear deal should be NOK supportive, as should Norway's April manufacturing PMI on Wednesday.

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