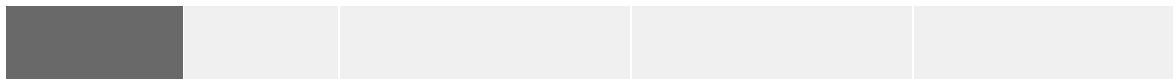


G10 FX Week Ahead: Achtung Baby

Away from the 'will they, won't they?' circus of the US-China trade drama, next week could bring news that Germany has fallen into a technical recession. That should keep the euro on the back foot, even if the risk environment continues to improve. Time to watch out, or 'Achtung Baby' as U2 might put it



Bono, the lead singer of U2 which released Achtung Baby in 1991



EUR: Conspicuous by its under-performance

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/USD | 1.1026 | Mildly Bearish  | 1.0990 - 1.1110 | 1.1000 |

- The EUR is performing pretty poorly, even though many asset classes are starting to price in a more positive trade environment. We think this FX performance represents the emergence of the EUR as a preferred funding currency on the view that interest rates in the eurozone will remain at rock bottom throughout 2020. Supporting this view should be German 3Q19 GDP data released on Thursday, which may well show a technical recession. Driving that weakness will be the industrial sector, and Eurozone IP data (Wednesday) should also tell the story of the manufacturing sector grinding to a halt. We doubt a modest uptick in the German ZEW survey (Tuesday) will provide much of a lift – instead, the November PMIs (released 22nd-25th) will be more significant.
- In the US, the focus will remain on the trade story. The market would prefer having a date and a location (none exists at the moment) for a US-China trade deal and without that it may be reluctant to take risk assets (and Treasury yields) too much higher. This especially so because Chinese October activity data releases out later in the week should be soft. Unless US October retail sales (Friday) collapse, however, it looks like the recent benign conditions can continue; we're waiting for this year's monetary stimulus to show up in better confidence numbers. Wednesday's release of US October CPI figures – headline still at 1.7% YoY – are unlikely to mean much to a market more focused on activity right now. There's also Fed Chair Powell's address to Congress on Wednesday – though like other central banks the Fed looks to be in wait-and-see mode, pausing to see if their three rate cuts this year have curtailed the slow-down.

JPY: Bounded by 2% Treasury yields

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| USD/JPY | 109.33 | Mildly Bullish  | 108.70 - 110.30 | 109.00 |

- The apparent improvement in US-China trade has triggered a sharp steepening in the US yield curve as some optimism emerges over the return to a more normal trading environment. Our rates team thinks that steepening in the 2-10 curve is probably limited to the 30bp area, however. That suggests that US 10 year yields stall around 2.00%. Given USD/JPY typically has one of the tightest correlations with US yields, the above views suggest USD/JPY may not have too much more upside mileage at this stage – perhaps 110.80 might be the best case on the week if we are under-estimating the scale of this bond tantrum.
- In Japan, the focus will be on Thursday's release of 3Q19 GDP data – expected at 0.2% QoQ. It's expected to be supported by front-loaded consumption ahead of the October sales tax hike. We'll also be watching the regular portfolio flows data and whether Japanese buying of foreign bonds is accelerating. That's been implied by recent surveys of Life Insurance managers and Japan's largest fund manager, the GPIF, suggesting it was making room for larger unhedged foreign bond purchases. Indeed, we're starting to doubt whether USD/JPY will make it below 105 over coming quarters. We're also not too distracted by the President Trump impeachment process – which we rather see as noise for FX markets.

GBP: In limbo for now ahead of the crucial UK December election

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| GBP/USD | 1.2810 | Mildly Bearish  | 1.2700 - 1.2890 | 1.2600 |

- We are looking for range-bound GBP as the UK has entered its five-week election campaign period. The market seems to be already pricing a majority Conservative Party victory (a benign outcome for GBP in our view) which suggests a limited upside to GBP at this point. Should pre-election polls start to show rising odds of a hung Parliament, this would in our view lead to some reversal of sterling gains from the previous month.
- On the data front, the 3Q GDP growth (Monday) is to show a solid 0.4%QoQ rebound, but another sharp fall in the level of employment (Tuesday) would emphasise that the jobs market is no longer tightening. Hiring indicators point to deteriorating demand for staff amid Brexit and global uncertainty. Oct CPI inflation (Wednesday) should decline to 1.5%YoY, but Oct retail sales (Thursday) should rise by 3.3%YoY. Like the Bank of England meeting this week, the data should be of secondary importance for sterling and the effect on the currency should be short-lived and limited. All the matters for GBP at this point is the upcoming parliamentary elections. Our mildly bearish EUR/USD view suggests mildly lower GBP/USD next week.

AUD: The usual unemployment dilemma

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| AUD/USD | 0.6857 | Mildly Bullish  | 0.6810 - 0.6930 | 0.6900 |

- Over the last few months, the expectations for the RBA's rate path have been strictly connected to any marginal change in the inflation and unemployment data. This means that next week's labour report (for the month of October) has, once again, a make-or-break potential for the Australian dollar. In line with consensus (according to a Bloomberg survey), we expect the unemployment rate to remain at 5.2%. We believe such a number will not be enough to push the markets to take out anything from the 15bp currently priced in for the next six months. The risk remains that even a marginal 0.1% increase will give a pretext to pencil in an RBA cut.
- All in all, our expectations for an in-line unemployment print should allow the Aussie dollar to keep following the global risk mood. Bar any major development in US-China trade relationships it seems fair to expect a broadly stable global sentiment next week that should set AUD/USD to keep hovering around the 0.6900 level.

NZD: We expect the RBNZ to stay on hold

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|---|-----------------|----------------|
| NZD/USD | 0.6331 | Bullish  | 0.6270 - 0.6450 | 0.6400 |

- The RBNZ meets on Wednesday and markets are leaning in favour of a 25bp cut (65% implied probability). As we discussed in our RBNZ preview ("[One more cut from New Zealand's central bank?](#)"), we sense that the arguments in favour of an easing move are running thin. Our expectation is that the Bank will pause at this meeting, awaiting more developments in the internal and external environment. However, we acknowledge it is quite a tight call.
- Our stronger conviction, though, is that a cut on Wednesday would likely mark the end of the easing cycle, and the RBNZ may well flag such an intent to pause. In light of this, we expect the negative impact on NZD of a possible cut would be somewhat limited, as it should not give reasons to the market to pencil in more reductions in 2020. All in all, we expect a volatile week for the kiwi dollar but also see the balance of risks for NZD/USD tilted to the upside, considering too the still extensive short market positioning on NZD (-56% of open interest according to latest CFTC data).

CAD: Looking for some stabilisation

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| USD/CAD | 1.3231 | Neutral | 1.3110 - 1.3300 | 1.3100 |

- [The October jobs report](#) saw a negative change in the headline employment rate and, despite still very strong wage growth, it pushed USD/CAD deep into 1.32 territory. Some perceived cracks in the so-far very tight Canadian job market are pushing investors to keep following the easing lead deriving from the latest Bank of Canada meeting and are gradually increasing their bets for a rate cut in the next months.
- Our view is that there is a higher-than-perceived risk that the BoC will deliver a one-and-out insurance cut at the December 4th meeting. Some clarity on this point may come from next Thursday's speech by BoC governor Stephen Poloz. This is also likely to be the only idiosyncratic catalyst for the loonie next week that otherwise will remain mostly driven by the US-China trade-related news flow. Bar any major setback in talks, it seems likely that a support risk environment should prevent USD/CAD from rallying much more.

CHF: EUR/CHF breaking lower

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/CHF | 1.0989 | Mildly Bearish  | 1.0900 - 1.1050 | 1.0900 |

- We expect EUR/CHF to remain on a mildly depreciating trajectory next week for three main reasons. First, the euro is increasingly taking the form of a funding currency and not cashing in on the positive news flow about US-China trade negotiations. Second, other G10 safe havens (JPY, USD) are showing good resilience to the risk-on environment. And third, Germany entering a technical recession may prompt some investors to seek shelter in the Swiss franc (normally the preferred safe haven to eurozone woes).
- All this suggests that even if we expect global risk appetite to remain fairly supported next week, we see a high potential of EUR/CHF break below the 100d-MA (currently at 1.0975) that has proven to be a quite solid support of late.

NOK: Retaining momentum

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|---------|--|------------------|----------------|
| EUR/NOK | 10.0940 | Mildly Bearish  | 9.9750 - 10.2000 | 10.2000 |

- The very strong PMI read at the start of the week set the krone for a week of gains, with EUR/NOK now back below 1.10 after touching all-time highs of 1.25 at the end of October. Next week, the positive momentum for NOK will be tested by two key data releases. The October inflation report, out on Monday, should mark a YoY increase from 1.5% to 1.8% (according to Bloomberg consensus data) in the headline, although the increase should be more marginal in the underlying print (from 2.2% to 2.3%). On Tuesday, the Q3 GDP numbers should point to further resilience in the economy, with activity still benefitting from robust investments in the oil sector.
- The data flow is likely to remain fairly constructive, although the pass-through to higher rate expectations will likely be limited given that the Norges Bank has clearly signalled the intention to keep rates at the current level in the foreseeable future. However, with supported risk sentiment still fuelling a stabilisation in oil prices, we see little reasons to expect a correction in the krone next week and we expect more downside in EUR/NOK.

SEK: Offsetting drivers

| | Spot | Week ahead bias | Range next week | 1 month target |
|---------|---------|-----------------|-------------------|----------------|
| EUR/SEK | 10.7000 | Neutral | 10.6080 - 10.8000 | 10.8500 |

- Markets have increasingly aligned with the Riksbank-announced rate path this week, with the implied probability of a hike in December having risen to 77%. Next week will mostly be about data releases, although we suspect that some strong data disappointment will be needed to undermine the notion that the Bank will abandon negative rates next month. The October CPI read will attract most attention, likely signalling that inflation remains broadly in line with the Riksbank forecast, which could result in investors still reluctant to believe in the December hike to price it in further. Also, it's worthwhile keeping an eye on the Prospera survey, mainly for long-term (5Y) inflation expectation as to whether the recent downtrend will keep on going for longer.
- Given the high beta of SEK to Eurozone economic sentiment, we may see some negative spill-over effect on the krona from another round of uninspiring data, especially as Germany (Sweden's main trading partner) is set to enter a technical recession. This may offset most of the upsides coming from markets cementing their expectations for a December hike and keep EUR/SEK broadly range-bound.

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