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Article

G10 FX Week Ahead: Batten down the hatches

Despite the IMF probably agreeing to Argentina's request to front-load aid, we think it's going to be another tough week for emerging markets. On Thursday, President Trump could well push the button on the next round of Chinese tariffs, keeping $/EM bid. Strong US payrolls and Italian budgetary concerns should also keep the dollar in demand

EUR: Trade war rhetoric trumps data deluge

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1585	Mildly Bearish	1.1510 - 1.1660	1.1500

- It will be a fairly busy US data week after the US markets open on Tuesday after the Labor Day holiday and our economists anticipate a solid stream of US data. The August Non-Farm Payrolls due Friday should rebound above 200K (as other labour data releases have suggested the jobs market remains robust), wage growth also due on Friday should increase to 2.8% year on year, and Aug ISM non-manufacturing due Thursday should tick higher. Although a solid stream of data, we look for a fairly limited direct spill over into EUR/USD, as the market is already pricing close to two Federal Reserve rate hikes for the remainder of the year.
- In the eurozone, the expected rise in eurozone July retail sales due Wednesday and German July industrial production due Friday should be mildly positive for the euro pointing to a good start for the economy going into the third quarter (following the disappointing data in the last few months). Yet, the main driver for the EUR/USD is likely to be the US rhetoric on trade. The risk of a more meaningful escalation of trade wars and more negative headline news (particularly as the US public consultation period on the effect of Chinese tariffs ends on Thursday) points to some downside risks to EUR/USD next week.

GBP: The fading Brexit risk premium

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2980	Neutral	1.2900 - 1.3100	1.3000

- It appears that there may be some Brexit hope. GBP markets were caught off guard as the EU's Brexit negotiator Michel Barnier said they were "ready to propose a partnership the likes of which has not existed before with any third country". This is something that most hadn't thought was possible and may see a partial reassessment of 'no deal Brexit' risks that lends support to a politically-infested sterling. Indeed, while we're not jumping to any conclusions about the final Brexit deal, recent comments by Barnier and the Brexit secretary Dominic Raab suggesting negotiations remain on track may be enough to ruffle the feathers of speculative GBP investors that have latched onto a bearish no deal Brexit story. Two-way Brexit risks means investors may now think twice about shorting the pound - and this could command a smaller risk Brexit premium in price of GBP.
- GBP could remain supported amid all this short-term political noise if UK economic data

continues to hold up. The week ahead will see the Aug PMI releases (manufacturing on Mon) - as well as Governor Mark Carney and his MPC colleagues testifying to UK Parliament following the Bank's recent decision to hike interest rates on Wednesday. We suspect Brexit will be high up on the agenda - although watch for commentary on the current economic environment and how this will influence the MPC's future policy decisions. Indeed, it doesn't appear that no deal Brexit risks are having any direct material impact on the real economy just yet - and certainly not anything GBP's undervalued price doesn't already reflect.

JPY: Everybody's friend

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	111.00	Mildly Bearish	110.00 - 111.35	108.00

- Despite the sharp sell-off in emerging market currencies over recent weeks, US asset markets have proved resilient – and that probably explains why USD/JPY continues to be bid in a 110-112 range. We remain wary that escalating US protectionism at some point will reverberate back into US equities. Will the next set of US tariffs on China be the straw that breaks the camel's back? Thursday is the day when President Trump could make his move on the next US$200bn worth of Chinese imports – a move that should be negative for risk. Wednesday also sees US social media executives testify on Russian election meddling which could re-focus attention on Russian sanctions.
- A decent US jobs number on Friday, in theory, should be supportive of USD/JPY, but we think investors will be looking to position long JPY against EM and activity currencies over coming months – which should limit USD/JPY upside to the 111.50/112.00 area. Locally Japan sees 2Q18 capex data on Monday and then the composite PMI data on Wednesday. There remains low-level noise on the normalisation of Bank of Japan policy, but with China slowing and emerging markets vulnerable we doubt this proves a serious driver of JPY pricing.

AUD: Getting ready to go down under 0.70

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7220	Bearish	0.7150 - 0.7350	0.7200

- Last week we said the Aussie dollar hasn't really got a lot going for it - and lingering hopes of a Reserve Bank of Australia rate hike in 2H19 may have been the only thing propping up the currency. Those hopes were severely dented after Westpac Bank's decision to independently raise mortgage lending rates citing a structural increase in wholesale funding costs. Should the other major domestic banks follow, this will reduce the need for the RBA to raise the benchmark cash rate (policy rate) and reduce the likelihood of a rise in market rates that matter for the currency. The September RBA meeting on Tuesday may shed further light on this, and there's a risk that policymakers soften their language over a possible policy hike.
- With President Trump talking about increasing tariffs on China again, we think the high-beta AUD will continue to find little love from investors. The dismal 2Q Private Capex data didn't help either, and this could feed through into a softer 2Q Australia GDP print due Wednesday. We see growing risks of AUD/USD moving down to 0.70 by year-end and potentially going down under this key level if the geopolitical backdrop deteriorates further.

NZD: Growing market noise over a rate cut

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6630	Mildly Bearish	0.6550 - 0.6720	0.6600

- Relative to the other G10 dollar-bloc currencies, the week ahead will be pretty quiet for the New Zealand dollar. The Global Dairy Trade auction on Tuesday poses some event risk - not least as falling dairy prices, and weaker terms of trade have also been weighing on the kiwi of late. Some consolidation here would be welcome news in an otherwise pretty bearish backdrop for the currency.
- Markets are gaining conviction over the fact that the Reserve bank of New Zealand's next policy move will be a cut - rather than a hike. Widening rate differentials are likely to continue weighing on NZD crosses over the coming months. If global growth and trade also take a real hit, NZD/USD could find itself closer to 0.60 (as opposed to 0.70) by year-end.

CAD: September rate hike closer than markets anticipate

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3040	Mildly Bearish	1.2900 - 1.3100	1.2800

- While the NAFTA 2.0 rumours (and they remain rumours at the time of writing) have been seemingly positive for the Canadian dollar, the subtle miss in the 2Q Canadian GDP print has seen markets all but price out the prospect of a surprise Bank of Canada hike in the week ahead. The September BoC meeting due to take place on Wednesday may now be a platform for policymakers to signal an October rate hike conditional on domestic data staying firm. Although we wouldn't completely rule out the idea of a surprise rate hike (the argument that 'Poloz didn't warn us' is a trap that regular BoC watchers know not to fall for). The BoC may also opt to play it cool given the extremely flat Canadian yield curve (which risks inverting if the BoC push short-term rates higher too fast).
- Either way, we think the hawkish signals stemming from the September meeting - coupled with hopes of a NAFTA 2.0 deal - will keep the loonie relatively bid in the short-term. We like positioning for a tactical USD/CAD move lower and continue to see scope for move to 1.27-1.28 in the coming weeks. Oil prices and geopolitical risks are the obvious headwinds to this strategy.

CHF: BTP Watch

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1250	Bearish	1.1130 - 1.1320	1.1000

- The push in the Italian BTP: German Bund spread close to 300bp has not been lost on EUR/CHF, which is currently breaking to new lows for the year. Monday will give investors the chance to react to any Italian sovereign rating comments by Fitch on Friday, although the much more significant impact on this subject will not emerge until late September (when the Italian government submits its 2019 budget) and late October (when S&P rates Italy having seen that budget). This story should keep EUR/CHF under pressure in its role as the EMU-stress hedge – despite the speculation around the levels the Swiss National bank may buy EUR/CHF as part of their monetary policy strategy.

- We also wonder whether the looming acceleration in US sanctions against Russia is also triggering demand for the franc. Russian investors and retail may not want the USD exposure ahead of sanctions which could target some of the largest Russian banks. In Switzerland, the data calendar this week will see August CPI on Tuesday (seen at 1.2% YoY) and 2Q18 GDP on Thursday. However, CHF out-performance looks the bias.

SEK: Crunch time

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.6300	Mildly Bullish	10.4870 - 10.7500	10.6000

- Ahead of the Swedish elections next weekend (9 September), all eyes are on the Riskbank policy meeting on Thursday. Although SEK is meaningfully weaker vs the Riksbank's forecast, our base case remains a modestly dovish Riksbank tone with the bank (a) likely signalling a delay to interest rate hikes; (b) citing concerns about the low Swedish core inflation. No help should be therefore expected from the Riksbank ahead of the elections with the latter being a high hurdle for investors to engage back into SEK longs. Given two major risk events over the course of the next week, EUR/SEK volatility will remain elevated, as evident by the inverted EUR/SEK implied volatility curve.
- We remain bearish on SEK and expect the currency to weaken further to EUR/SEK 11.00 towards year-end as the external environment as well as the domestic factors (such as the seasonal decline in Swedish interbank rates in Q4) continue weighing on the SEK.

NOK: Externally driven

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.7230	Neutral	9.6720 - 9.7790	9.6000

- In a fairly quiet week on the Norwegian data front, NOK will continue being driven by the general risk sentiment. Despite high oil prices and the Norges Bank moving towards the September rate hike, the pro-cyclical NOK is currently weak and feeling the spillovers from both the global EM FX weakness as well as the idiosyncratic SEK decline.
- This pattern is unlikely to change next week, limiting the potential for a more significant NOK recovery. Domestically, the August PMI manufacturing due Monday and July industrial production due Friday will be in focus, but unlikely to significantly alter NOK price action given that the market discounts the hawkish central bank effect and puts more emphasis on the general risk sentiment in terms of NOK price action.

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