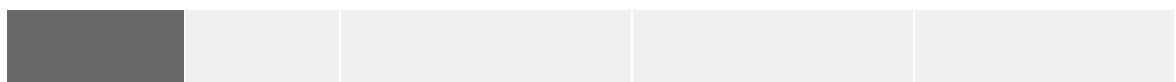


## G10 FX Week Ahead: Dry January

Central bankers in the eurozone, Japan, Canada and Norway announce their policy decisions next week but don't get too excited, caution will likely prevail and no changes are on the horizon. Barring a major disappointment, UK data may pour cold water on expectations for a Bank of England rate cut, suggesting it will be a "dry January" for all G10 central banks



New ECB President, Christine Lagarde, rarely drinks alcohol



## EUR: Uneventful ECB Jan meeting unlikely to shake the EUR/USD tight range

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/USD | 1.1101 | Neutral         | 1.1060 - 1.1200 | 1.1100         |

- The European Central Bank meeting (Thursday) should be a non-event. No new economic projections are published and the board's risk assessment is unlikely to change compared to the December outlook. While the ECB's strategic review is set to begin soon, it won't be completed until year-end and in the meantime, the narrative is unlikely to change. Hence, a fairly limited impact on the euro stemming from this meeting. As for the January eurozone PMI (Friday), our economists look for a modest improvement, though the Manufacturing PMI should remain in contractionary territory. Still, stabilising / modestly improving eurozone PMIs fit the current ECB outlook for stability and hopes for a rebound. This, in turn, underscores the fact that there is no need for an imminent change in the policy stance. With no ECB policy normalisation on the horizon any time soon, EUR upside appears to be off the table.
- In the US, it is a fairly quiet day on the data front. December US Existing home sales (Wednesday) should not materially change the dollar's prospects. Rising speculation about possible US tax cuts might be seen as marginally positive for the US dollar vs the low-yielding euro, as it would benefit the dollar via (a) the improved growth channel, and (b) further reduce the odds of a Federal Reserve rate cut this year (which is still almost fully priced in). As for next week, expect EUR/USD to remain in a tight range, as has been the case for the past few weeks.

## JPY: No rebound in sight

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| USD/JPY | 110.12 | Mildly Bullish  | 109.50 - 111.30 | 110.00         |

- The trail of global upbeat sentiment left by the signing of the 'phase one' trade deal leaves the door open for a week of stabilising risk appetite, leaving regional stories to drive FX moves. Japanese yen bulls must, therefore, rely on some internal push to the currency to prevent USD/JPY from consolidating above 110. Our suspicion, however, is that they may be left high and dry.
- The Bank of Japan will announce policy on Tuesday but the potential for surprise appears to be low. With no monetary ammunition left to support the economy, BOJ Governor Haruhiko Kuroda will have to be content with the \$120 billion of fiscal spending announced in December to soften the impact of the recent consumption tax hike. CPI numbers out on Thursday may show a marginal advance, but this is unlikely to lift the depressed Japanese rate environment. All in all, we see a definitive move back below 110 in USD/JPY as unlikely next week.

## GBP: As bad news is priced in, GBP reaction to UK data will be asymmetric

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| GBP/USD | 1.3035 | Neutral         | 1.2950 - 1.3200 | 1.2800         |

- A stream of disappointing UK data has confirmed the MPC's concerns and sharply increased the odds of a January rate cut. Both November UK labour data (Tuesday) and January PMIs (Friday) will be crucial factors to watch next week. A downside surprise or signs that the data is not improving would likely cement market expectations of a cut this month. However, the market has already pencilled in this move as its base case (currently priced with a 70% probability) and is looking for another partial cut in the remainder of the year. This suggests that the downside to sterling may be limited. Indeed, disappointing retail sales for December sparked only a muted reaction in the currency on Friday. If anything, the risks are skewed to more pronounced GBP upside (than downside) next week, as a possible rebound in PMIs would reverse expectations of monetary easing. Hence, our asymmetric GBP/USD range with an upside skew for next week (1.2950-1.3200).
- Even if the UK data improves and the BoE refrains from cutting rates in January, the spectre of a cut in the months to come (given the clear easing bias) as well as the uncertainty about the form of a UK-EU trade deal suggest that any rebound in sterling should be shallow. The fact that the speculative positioning is no longer stretched (turning from meaningful shorts to modest longs) also suggests limited upside potential for GBP.

## AUD: Brace for labour data impact

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| AUD/USD | 0.6886 | Neutral         | 0.6800 - 0.6950 | 0.6800         |

- The Aussie dollar, the G10 currency most exposed to China-related sentiment, has not been able to take full advantage of the good Chinese data and the signing of a 'phase one' trade deal. Moving forward, it will be up to domestic drivers to direct trading, although stabilising risk sentiment offers a supportive underlying narrative to the commodity bloc.
- The focus will be on labour data for December, out on the night between Wednesday and Thursday in European time zones. With markets increasingly torn around the prospect of another rate cut in the next few months (the bushfire emergency is likely offering another reason for RBA action), a marginal +/- 0.1% change in headline unemployment will make a big difference. We forecast – in line with consensus – that unemployment held at 5.2% in December, with the employment change slowing to 18k (consensus 11k). If we're right, AUD may get a free pass and enjoy the global benign risk environment. But the downside risks remain significant (higher than its peers CAD and NZD) and caution is warranted.

## NZD: Inflation back to target?

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| NZD/USD | 0.6619 | Bullish ↗       | 0.6580 - 0.6720 | 0.6600         |

- Regional stories will take centre stage next week, and the Kiwi dollar has a big data release to bring to the party. Inflation for 4Q19 is going to be pivotal due to its quarterly frequency and because it may well signal a tick-up in the headline rate towards the Reserve Bank of New Zealand's 2% target mid-point. The consensus is centred around an increase to 1.8% (from 1.5% in 3Q) and we see room for an even stronger reading.
- This should cement market expectations for the RBNZ to stay put for the foreseeable future and convince investors that the central bank will retain its neutral stance despite a possible dovish steer from its counterpart in Australia. In light of this, we continue to see sizable downside potential for AUD/NZD, not only on the back of policy divergence, but also as the bushfire emergency raises the risk of a higher growth differential leaning in favour of New Zealand.

## CAD: BoC on hold, for now

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|------------------|-----------------|----------------|
| USD/CAD | 1.3058 | Mildly Bullish ↗ | 1.3000 - 1.3180 | 1.3000         |

- The Bank of Canada meets next week immediately after December CPI readings (which should continue to indicate that inflation is at target). While the Bank is unlikely to change its current stance following better-than-expected labour market data, investors will be keen to look at any change in the Monetary Policy Report outlook to assess the possibility of a cut in the coming months. Markets are still underestimating the probability of BoC easing in our view, and we could see some correction as soon as next week if the MPR forecasts signal a less upbeat tone on the economic outlook.
- In terms of FX impact, with virtually no easing priced in for the first half of this year, we continue to see the Bank of Canada as a factor that could curb the Canadian dollar in the next few months rather than offer support. With oil prospects also looking unsupportive, we think a decisive break below 1.30 in USD/CAD is unlikely right now, despite the upbeat global risk tone.

**CHF: Testing SNB's patience (and keeping an eye on Italy)**

|         | Spot   | Week ahead bias | Range next week | 1 month target |
|---------|--------|-----------------|-----------------|----------------|
| EUR/CHF | 1.0740 | Neutral         | 1.0700 - 1.0800 | 1.0800         |

- The Swiss franc's tumultuous week ends with EUR/CHF resisting any decisive move towards 1.0700. A generally supportive environment for risk assets next week may help put a floor below the pair, especially if the ECB meeting provides further respite to EGB rates.
- However, the general feeling is that the Treasury FX report has opened a can of worms and we can't exclude the possibility that markets will further test the SNB limits for FX intervention. In the next couple of weeks, Italian politics might come back to haunt EUR/CHF (the franc is generally the preferred channel to price in Italy-related risk in FX). Ahead of regional elections in Emilia Romagna on 26 January, the centre-left PD (in the ruling coalition with the 5 Star Movement) is marginally ahead in the polls. A surprise win by the right-wing League in what is an historically left-wing area bears the risk of the PD abandoning the government and throwing Italy back into political turmoil (snap elections would likely follow).

**NOK: No fireworks from NB, but stable risk sentiment benefits the krone**

|         | Spot   | Week ahead bias  | Range next week | 1 month target |
|---------|--------|--|-----------------|----------------|
| EUR/NOK | 9.8851 | Mildly Bearish  | 9.8150 - 9.9470 | 9.8000         |

- The Norges Bank meeting (Thursday) should have limited impact on the Norwegian krone. No new projections are published, the Governor doesn't hold a press conference and the NB statement should reiterate the message from the December NB meeting (rates likely on hold in 2020, though the forecast pencils in a partial probability of a hike).
- With the risk environment remaining stable and positive NOK seasonality in January and February, we look for a modest downside EUR/NOK bias next week, with the pair slowly converging towards the 9.80 level.

## SEK: Krona to lag its G10 cyclical FX peers

|         | Spot    | Week ahead bias | Range next week   | 1 month target |
|---------|---------|-----------------|-------------------|----------------|
| EUR/SEK | 10.5540 | Neutral         | 10.4840 - 10.6000 | 10.6000        |

- Despite the stabilising global risk appetite, gains for the Swedish krona should remain muted. Domestic economic data doesn't suggest a follow-up to the Riksbank's one-and-done hike in December (all measures of the December CPI remained below the 2% target) while SEK, even after the December rate hike, still shows the lowest nominal yield among cyclical G10 currencies (and the lowest / most negative real yield in the entire G10 FX space).
- We continue to expect EUR/SEK dips below the 10.50 level to be shallow and short-lived and SEK to lag its G10 cyclical FX peers. As for the economic data next week, it is very quiet week, so no impact on the currency here.

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