G10 FX Week Ahead: Easing the pain

Markets are raising their expectations for central banks to step in with monetary easing to counter the effects of Covid-19. Risk-sensitive currencies suffering may not be over just yet, while safe-haven JPY and EUR appear set for another good week. Keep an eye on the CAD, as the Canadian central bank may deliver a surprise rate cut

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USD: Waiting on the Powell Put

	Spot	Week ahead bias	Range next week	1 month target
DXY	98.6560	Mildly Bearish	97.7000 - 99.0000	97.0000

- The spread of Covid-19, its impact on equity markets and what the Fed will do about it are the central focus right now. Investors are fearful that there is more bad news out there and have now priced in one full 25bp Fed cut for the 18 March meeting. Were equities to fall, say, another 10% early next week we could be moving closer to the kind of co-ordinated central bank rate cuts last seen in 2008. For the very short term, much weaker equities and a much deeper Fed easing cycle are a dollar negative.
- Event risk calendars will be of secondary importance next week. Two issues stand out, though: i) US Democratic primaries and ii) US labour market data. On the former, Saturday sees the South Carolina primary where Biden needs to resurrect his campaign. Tuesday is 'Super' and should provide a better indication as to whether Bernie Sanders really is the front-runner. Much weaker equities, (hurting Trump's chances of re-election) and Sanders leading the Democratic polls would be a nasty cocktail for the dollar. On the labour market data, it may be too early to see much of a slowdown here and instead the market will look out for insights from the Fed in the last week before the black-out period ahead of the 18 March FOMC meeting.

EUR: The wrong kind of rally

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.0966	Mildly Bullish	1.0920 - 1.1100	1.1000

- EUR/USD is rallying on the back of broad-based de-leveraging. Recall that the EUR had become a popular funding currency and we've recently seen huge unwinds of popular carry trades in high yield EM currencies, such as RUB, ZAR and MXN. The ECB will be in no mood to jump in with a pre-emptive rate cuts, but could be forced to act were equities to continue to fall hard. Here the market looks like it is pricing a 10bp ECB rate cut over coming months. It is still not clear the ECB would go with a rate cut – e.g. an increase in the tiering of deposits is another option – but we hear little from the ECB ahead of the 12 March meeting.
- The first look at February CPI and retail sales are the key Eurozone releases in the week ahead. Despite some better activity data in January, the fear is that Covid-19 will hit Europe hard in 1H20 and that is why we view the current EUR/USD rally as short-term and corrective in nature.

JPY: The genuine safe haven

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	108.46	Bearish ↘	107.00 - 109.30	108.00

- Having toyed with the upside earlier this month, USD/JPY has re-connected with equities in a big way. In fact correlation analysis shows the bigger the equity fall, the higher the correlation. Now that we have seen the biggest surge in the Vix (equity volatility) since the Global Financial Crisis, the JPY's safe-haven status comes to the fore. Here Japan's Net Foreign Asset position (after years of trade surpluses) keeps the JPY insulated when it comes to capital repatriation and the dollar is just starting to lose its sheen. Of course the path of equities early next week will be a major determinant in where $/JPY goes – but we would say that both look vulnerable.
- Japan's economy will be hit hard by the virus – and the loss of the Olympics would be a major shock. However, this is a global shock and not an Asian Regional shock, such that the JPY will remain the outperformer whilst this equity correction unfolds. The BoJ doesn't like what negative rates and the flat yield curve is doing to local banking profitability, but could offer 10bp in rate cuts were any co-ordinated central bank action necessary (10bp of cuts seem to be priced for the 28 April BoJ meeting).

GBP: A replica of the past week?

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2828	Mildly Bearish ↘	1.2700 - 1.2920	1.2700

- Sterling is acting as the wild card in a Coronavirus-dominated market, mostly reliant on investors' mood when it comes to fiscal stimulus expectations ahead of the UK budget and UK-EU trade negotiations. Next week, these two drivers will remain predominant, as the calendar offers very little in terms of market-moving data releases.
- The UK and the EU will sit at the negotiating table on Monday and we suspect the highly confrontational tone after the recent remarks by UK officials will keep prevailing in the headlines. This should translate into additional uncertainty regarding the future of UK trade relationships with the bloc and selling pressure on sterling should remain sustained. On the budget side, ahead of the official release on 11 March, the few hints that markets will receive are likely going to erase the expectations of fiscal stimulus in excess of what had already been factored by investors before the cabinet reshuffle. In light of this we may see EUR/GBP consolidate above 0.85 and GBP/USD edging below 1.28 next week.

AUD: RBA unlikely to help the Aussie

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.6510	Bearish ↘	0.6360 - 0.6560	0.6600

- A tumultuous week for global risk took a toll on the already vulnerable AUD, which is now down by around 5% since the Covid-19 went public. While this seems like a sizeable drop, it may have been way more pronounced if it wasn't for a combination of a hawkish RBA and broadly supportive data flow, which partly limited the losses.
- Next week, these positive catalysts may fail to provide additional support to AUD. The RBA (rate announcement on Tuesday) will hardly be able to deliver another hawkish surprise. As we highlighted in our preview ("Australia's central bank to stand pat, with a possible dovish tilt"), we sense there is a divergence between the downside risks to the Australian economic outlook (Covid-19 and bushfires, above all) and what the RBA has been acknowledged lately. If nothing else, this sets the bar for another hawkish surprise quite high. In terms of data releases, GDP numbers for 4Q will be closely watched, but considering they refer to a pre-Coronavirus and pre-bushfires period, it may have somewhat limited implications for AUD. January retail sales on Friday may instead take a hit from the bushfires emergency and show a contraction. All in all, we see AUD still not having all the negatives in the price and therefore leaving room for more downside next week as the RBA and data may hardly prove supportive.

NZD: Facing less pressure than AUD

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6240	Bearish ↘	0.6140 - 0.6290	0.6400

- As the Covid-19 became public, the NZD had a neutral positioning compared to the deep short net positioning of AUD, which left more downside room for the NZD as market sentiment deteriorated and the prospect of a Chinese slowdown emerged. The latest CFTC speculative positioning data showed a significant jump in net Kiwi dollar shorts, that exceeded the AUD net shorts. With the AUD "positioning advance" coming to an end, the room for AUD/NZD underperformance appears wider.
- Next week may be the right one for AUD/NZD to make a decisive move lower: no key data releases in New Zealand, while the AUD is facing downside risks from the RBA meeting (more details in the AUD section above). Looking at the NZD/USD, the feeling is that we may see another leg lower on the back of a lingering global risk aversion in the markets.

CAD: Watch for a BoC surprise cut

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3444	Bullish	1.3350 - 1.3700	1.3300

- Markets have added a big deal of BoC easing in the CA curve, in line with rising expectations for Fed additional stimulus. This has contributed to the negatives already stemming from the slump in oil prices and the ongoing demonstrations in Canada to set the loonie as a key underperformer this week.
- Next week, the Bank of Canada will announce monetary policy, and despite we acknowledge it is a close call, our expectations lean slightly in favour of a cut. This would likely be shaped as an "insurance" cut on the back of the mounting external risks to the outlook. As highlighted in our recent CAD outlook update, one cut would not severely dent the highly attractive CAD yield advantage. Next week will not only be about the BoC, though. The OPEC+ meeting is set to have a make or break implications for CAD. As noted by our commodities team, the expectations of the markets in terms of output cuts are quite high, especially considering the latest slump in prices. Anything that falls short of the OPEC+ joint technical committee recommendations (extend current cuts till year end and add 600Mbbls/d over 2Q20) may well add pressure on oil prices. Looking at data releases, watch for payrolls numbers on Friday, as markets will look for indications that the strong January jobs report was not an outlier.

CHF: Buying interest unlikely to ease

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0594	Mildly Bearish	1.0520 - 1.0630	1.0500

- The rally in the EUR has partly prevented a fully-fledged fall in EUR/CHF that would have been warranted by the rising risk sentiment. The feeling is that EUR/CHF is likely trading more than a nudge above what the global risks environment and in particular the downside risks to the Euro Area stemming from Covid-19 would warrant. The rise in SNB sight deposits indicate a certain degree of intervention in the FX market is likely underway. However, the franc is often the key safe-haven when it comes to risks related to Italy. The BTP-bund 10y yield spread has risen by approximately 40bp for now, but the move still appears relatively contained when compared to previous instances (Italian political crises). As we highlighted in a recent publication, we may see some additional pressure on Italian bonds which may translate into some downward pressure to EUR/CHF.
- In terms of data releases, growth and inflation data in Switzerland next week will be watched but should continue to highlight a fairly negative picture. In particular, CPI should inch a tad lower to 0.1% according to consensus. More importantly, the foreign currency reserves data for February released on Friday will provide some better indication around any SNB market intervention, although the valuation changes may once again put a limit to the explanatory power of the release.

NOK: The most vulnerable European G10 currency

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.3950	Mildly Bullish	10.2500 - 10.5000	10.4500

- NOK remains one of the most vulnerable G10 currencies, suffering from this high sensitivity to equity markets and the falling oil prices. Although stretched in valuation terms (as are other G10 commodity currencies such as AUD and NZD) in the current falling markets the valuation is not providing much cushion. Being cautious on risk sentient for the next week, we have modest upside bias for EUR/NOK.
- On the domestic data front, PMI Manufacturing (Mon) and Jan Industrial Production (Fri) will be the key data points to watch, yet unlikely to have a meaningful impact on the NOK price action, as the Covid 19-related risk sentiment remains the key driver of the currency market.

SEK: Struggling vs EUR but outperforming its G10 peers

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	10.6740	Mildly Bullish	10.5900 - 10.7520	10.7000

- While SEK struggles along with higher beta currencies, currently is an outperformer among the cyclical G10 currencies (NOK, AUD, NZD, CAD) given its lack of commodity exposure. The drop in NOK/SEK below 1.0300 provides the case in point. As the risk sentiment is likely to remain fragile, EUR/SEK is likely to move above the 10.70 level, yet in the current down-market it should still continue outperforming NOK.
- Domestic Swedish economic data should continue playing the second fiddle to the general risk sentiment (also because it will have a limited implication for the Riksbank stance at this point). Hence, Feb Manufacturing PMIs (Mon) or Jan Industrial Production (Thu) should have a limited impact on SEK next week.

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