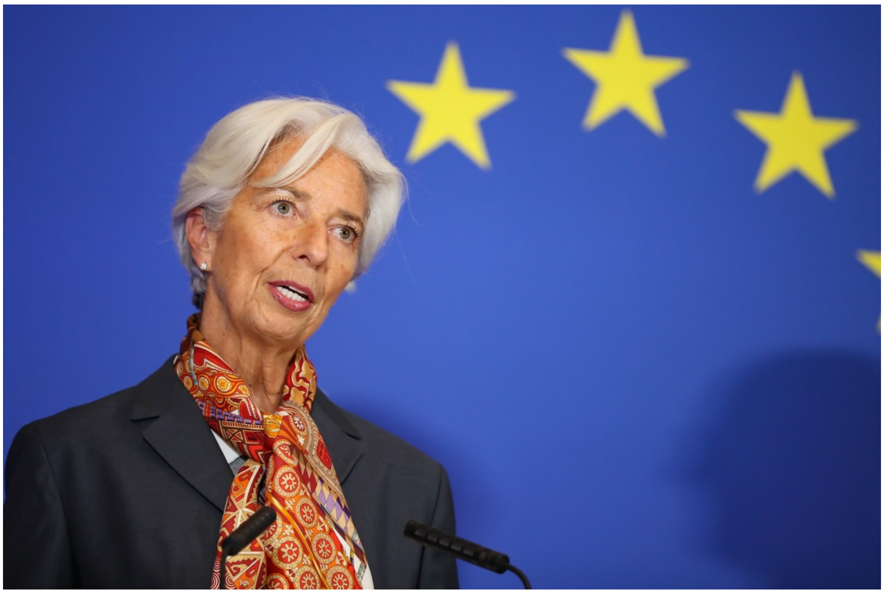
G10 FX Week Ahead: ECB shows the way

All eyes will be on the July ECB meeting next week, and its possible shift towards a dovish bias. While this would be negative for the euro, the cautious ECB would give some helping hand to cyclical FX. We don't see the dollar extending its recent good broad-based momentum next week



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USD: The dollar momentum not to be extended

	Spot	Week ahead bias	Range next week	1 month target
DXY	92.5440	Mildly Bearish ↘	92.0000 - 93.0000	92.5000

- The cautious tone by Fed Chair Jerome Powell about the risks of persistent inflation and the need to taper asset purchases was not enough to trigger a sustained recovery in risk sentiment. Still, we look for a limited upside to trade weighed dollar next week. Not only it is a fairly calm week on the US data front (suggesting limited catalysts for a domestically driven USD rally), but the possibly cautious / dovish ECB next week can provide a boost to cyclical FX, which would also spill over into the USD crosses (though EUR/USD would still decline).
- Overall, we still see the latest risk correction as exaggerated. We do not see the dollar extending its good momentum into the coming months, so pro-cyclical currencies can still profit from the global reflation story and those backed by hawkish central banks from the search for carry (CAD, NZD, NOK in G10, BRL, MXN and RUB in EM).

EUR: All eyes on the ECB

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1816	Mildly Bearish ↘	1.1700 - 1.1910	1.2000

- The July ECB meeting next Thursday is the main event of the week. What was supposed to be a non-event has turned into a key focus point of the week following the release of the ECB's strategic review. With the ECB shifting the inflation target from 'below, but close to 2%' to '2%' with a commitment to symmetry, the new strategy can be interpreted as either a formalisation of what it has been doing over the last few years anyway or a step towards more dovishness, as 2% implies a more resolute effort.
- This means the distribution of probabilities is skewed to lower EUR/USD next week. No change in the ECB bias is unlikely to be enough to send the euro higher. At the same time, any ECB shift towards the dovish interpretation of the strategic review would underscore the recent downward EUR/USD trend. While not a discussion for next week, the ECB dovish bias would suggest that the total reduction of the monthly purchases in 2022 will be less than previously expected. Beyond the ECB meeting, the focus will be on the July PMI manufacturing and services readings due on Friday.

JPY: Helped by the strongest correlation with UST in a year

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.70	Mildly Bullish	109.70 - 110.10	111.00

- The re-flattening of the US yield curve has once again provided some support to the yen, which has been the only currency with the Kiwi dollar (more details in the NZD section below) able to outperform the dollar this week marginally. Interestingly, the 60-day correlation between USD/JPY and US 10-year yields is at the highest since June 2020.
- The Bank of Japan meeting today was, as usual, largely ignored by the currency market. Policymakers adjusted their growth forecasts, revising the 2021 fiscal year numbers lower and the 2022 fiscal year higher. However, most of the focus was on the announcement of a green lending plan and the allocation of some of the foreign holdings to foreign-currency-denominated green bonds. Next week, the Japanese calendar includes June's CPI report, which is expected to show the headline YoY figure having moved into mildly positive territory (+0.2% from -0.1%). That's unlikely to change much for JPY given the immovable BoJ policy stance, and US Treasury dynamics should remain the main driver for the yen. Some slight improvement in risk sentiment could prompt some JPY weakness, especially in the crosses.

GBP: A dovish ECB may possibly impact GBP/USD

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3837	Mildly Bearish	1.3690 - 1.3940	1.4000

- While we expect EUR/GBP to remain range-bound in the 0.85-0.86 area, the downside risks to EUR/USD next week means that GBP/USD should not gain much. If anything, the risks are skewed to GBP/USD re-testing the 1.3750 level if the ECB strikes a dovish tone. The 200-day moving average of 1.3690 should prove a strong support level on the downside.
- We have seen a shift in the communication from some of the BoE officials with MPC member Saunders and Deputy Governor Ramsden both indicating that the need to taper asset purchases may come earlier than expected. However, the impact on GBP was limited, partly because the next step in the eventual policy normalisation process (rate hikes) remains still some way off. Despite the increasing Covid-19 cases, the UK government will deliver the final part of the reopening / end of restrictions on 19 July.
- On the domestic data front, the focus will be on June retail sales and July PMI manufacturing and services (both on Friday).

AUD: Not only negatives

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7438	Mildly Bullish	0.7400 - 0.7530	0.7500

- The Aussie dollar failed to break above 0.7500 earlier this week when global sentiment appeared favourable and is now back to the 0.7430/50 region. It still appears to be mostly about external factors, and we doubt markets have built up a risk premium on AUD to account for yet another five-day lockdown in the state of Victoria.
- While a choppy risk sentiment and the unwinding of reflation trades have been the main driver of AUD lately, other external factors (although unable to invert the bearish trend) have been rather positive: China's 2Q numbers pointed at a steady recovery and iron ore has risen back to the early-July highs this week, also bucking a not-so-good trend in other commodities.
- Internally, another solid jobs report saw unemployment move back below 5.0%. Next week will be quiet in Australia data-wise, with some attention on the RBA minutes from the July meeting where the central bank remained very dovish and developments on Victoria's contagion situation. AUD can surely rebound in the short term if market sentiment stabilises (also thanks to a net-short positioning), but in the longer run, the unattractive carry compared to NZD, NOK and CAD may make it a laggard among activity currencies.

NZD: Case for an August RBNZ hike getting stronger

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7022	Mildly Bullish	0.6980 - 0.7100	0.7200

- The Kiwi dollar is the only activity G10 currency that managed to outperform the USD the week. This was due to a very hawkish RBNZ rate announcement on Wednesday, where policymakers ended the bond-buying programme and inflation jumping more than expected to 3.3% in June. As discussed in "New Zealand's central bank paves the way for 2021 hike", we now think the RBNZ will hike by 25 bp in August or October. Strong inflation numbers have helped the case for an August move, although we think we'll also need to see strong employment data in early August (before the meeting) to see a hike already in the summer.
- Next week will be very quiet data-wise in New Zealand, but some stabilisation in sentiment may see NZD remaining bid as the fresh prospect of an earlier-than-expected rate increase is further improving the NZD rate attractiveness.

CAD: Profit-taking got in the way, but outlook remains positive

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2578	Mildly Bearish	1.2430 - 1.2620	1.2300

- The Bank of Canada did what markets were expecting this week: cut the bond purchase programme by a further C$1bn. There might have been some expectations for more tapering or for a shift in the forward guidance, which ultimately might have contributed to the spike in USD/CAD after the meeting. But we think that was mostly a profit-taking event: after all, the market was extensively long the loonie according to the latest CFTC positioning data.
- As discussed in our BoC meeting review note, we continue to expect policymakers to end their asset purchase programme by the end of the year. We are still pencilling in the first-rate hike in 2H22, in line with the BoC guidance, but the risks are increasingly skewed towards an earlier rate increase, and markets may be given more and more reasons to bet on a 1H22 hike if the data flow remains strong and the BoC keeps tapering.
- Next week's calendar in Canada looks empty. External drivers should dominate (let's see if oil finds some support after a few weak weeks), but the central bank's hawkishness and evidence of strong economic recovery in Canada continue, in our view, to offer a supportive underlying story for the loonie.

CHF: Is 1.08 the bottom of the recent downtrend in EUR/CHF?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0861	Mildly Bullish	1.0820 - 1.0950	1.1000

- EUR/CHF dropped very close to the 1.0800 level this week, before bouncing back to the 1.0850 level yesterday. Indeed, the choppy risk environment is continuing to put downward pressure on the pair, and the SNB is likely stepping in with an increasing amount of FX interventions to curb the franc's strength.
- There have not been any domestic factors driving CHF of late, with only some comments by the central bank President Thomas Jordan worth noting, where he reiterated the lack of need to adjust the Bank's inflation-targeting framework and monetary policy mix.
- Next week, the ECB's rate announcement will be the main focus for EUR/CHF, as there are no market-moving events in Switzerland, but we do not expect a big market impact. The recent rise in Covid-19 cases in Europe had the potential of turning into a driver for more EUR/CHF downside, but the approach shown by France (which appears to be a shared one across Europe) not to react with new restrictions but encourage vaccination is holding markets from re-rating Eurozone growth prospects. When combined with the SNB substantial FX interventions, we think 1.08 could be the short-term lower bound for EUR/CHF.

NOK: Some room for recovery

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.3920	Mildly Bearish ↘	10.2700 - 10.5000	10.2000

- NOK has been set for a third straight week of losses, still suffering from having the highest beta to risk appetite in G10 and lately from oil prices losing some ground. It is also possible that we have witnessed some extended long-squeezing on NOK (the lack of CFTC data on NOK positions makes it hard to gauge positioning), and this may be partly explaining why the unwinding of some reflation/carry trades are hitting NOK the most.
- We continue to see a stabilisation in sentiment as the most likely scenario for the summer months and the next week, and the hawkishness of the Norges Bank as able to drive a sustained recovery in NOK. We expect EUR/NOK to move back to the 10.30 level next week. It is a very quiet week on the Norwegian data front, with 2Q industrial confidence (Thursday) unlikely to exert any effect over NOK.

SEK: All about the general risk sentiment

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2370	Mildly Bearish ↘	10.1520 - 10.3000	10.1000

- The Swedish June CPI numbers provided another sign that the CPI pressures in Sweden peaked, and Riksbank Governor Ingves comments that it is too early to withdraw the monetary stimulus further cemented the Riksbank's place on the more dovish spectrum among G10 central banks. With no helping hand to SEK coming from Riksbank, the currency will be largely dependent on the direction of the risk sentiment.
- Our view that the risk sentiment should stabilise next week (limited US data points to prompt idiosyncratic USD upside and possible dovish ECB that would benefit procyclical FX) should help the EUR/SEK return to the 10.10-10.20 range. On the upside, we expect EUR/SEK 10.30 to prove to be a strong resistance level – as was the case over the last 8 months.

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