G10 FX Week Ahead: Europe - for the many, not the few

Next week is all about Europe, with a "super Thursday" that includes an ECB meeting (a QE expansion is widely expected) and an EU summit which should mark the end of negotiations on the Recovery Fund and Brexit. On the latter, the impact of a deal on sterling may be somewhat contained. US stimulus hopes and vaccine approval from the FDA should keep USD pressured

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DXY: Congress and the FDA to keep bullish sentiment and the $ bear trend intact?

	Spot	Week ahead bias	Range next week	1 month target
DXY	90.7300	Mildly Bearish	90.0000 - 91.2000	90.0000

- The dollar continues to broadly decline, recently dropping through major support levels against both European and Asian currencies. This pro-growth dollar decline needs to be fed by good news on growth/vaccines and a Federal Reserve still prepared to keep rates on the floor. On the former, markets will be watching out for progress on the $908 billion bi-partisan stimulus bill in the US Senate and also whether the Food and Drug Administration approves the Pfizer/BioNTech vaccine when it meets on Thursday. Progress on both of those is good for risk assets and bad for the dollar.
- The US data calendar will be light after the nonfarm payrolls release, though there will be focus on November's small business optimism index (NFIB), November CPI and the December University of Michigan data including consumer sentiment and inflation expectations. Any pick up in 5-10 year inflation expectations (now 2.5%) suggests the Fed has been successful, real US rates are falling and the dollar bear trend should continue.

EUR: Super Thursday

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2150	Mildly Bullish	1.2020 - 1.2250	1.2000

- Thursday is shaping up to be a massive day for European event risk. The EU Leaders' summit, beginning Thursday, should shed light on progress on both the EU Recovery Fund and Brexit. Credible threats to write Poland and Hungary out of the EU Recovery Fund, even if it means shifting to emergency budgets in January, should be enough to secure a compromise here. And Brexit talks could have been resolved by this time as well. We'll also see the European Central Bank decision and press conference. A top-up and extension of the Pandemic Emergency Purchase Programme is widely expected. Let's see what President Christine Lagarde has to say about the euro. The market won't buy any description of EUR gains as 'brutal' – the trade weighted EUR is merely at the top of its four-month range owing to strong gains in Asian FX.
- There is not too much on the European data calendar next week apart from some October industrial production data and the German ZEW. As FX analysts, we think something like Chinese FX reserves (Monday) may be more interesting for EUR/USD. Korea has already reported a $10bn increase in November reserves, which points to a potentially large increase in Chinese FX reserves. Some 20/30% of this increase in reserves may get re-balanced into the EUR – annoying for the ECB, but something that has to be accepted as the world's number two FX reserve currency.

JPY: Big gains in Asia FX makes Tokyo more tolerant of JPY strength

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	104.00	Mildly Bearish	103.20 - 104.50	102.00

- Steepening in the US yield curve is a mixed blessing for USD/JPY. It is typically associated with JPY underperformance on the crosses. But at the same time, yield curve steepening encourages Japanese investors in US debt to increase FX hedge ratios – selling dollars. If we're right with a broadly positive week for risk (i.e. no tremors out of Europe), then strong flows out of the dollar should send USD/JPY towards 103.
- Local Japanese data includes the October current account (a JPY-positive rebound to JPY1.8trn is expected) and some core machine orders data. As an aside, the major advances in China's yuan, Korea's won and the Taiwan dollar should make Tokyo more tolerant of strength in the yen – supporting our call for a lower USD/JPY.

GBP: The final word

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3490	Bullish	1.3350 - 1.3750	1.3600

- The rollercoaster of news around Brexit negotiations made sterling fall first to the 1.33 area and then sharply recover to 1.35 this week. In practice, we don't know much more than what we did last week in terms of the possible compromise on the key issues: level playing field and fisheries. What we know, however, is that more than one official has pointed out that a deal may come this weekend. On the other hand, France has significantly toughened its stance and officially threatened to veto any deal if it does not like the terms. The question about the timing and the outcome of negotiations remain open and leaves sterling in another make-or-break situation.
- We are still inclined to think a deal will be agreed, and it looks like both sides want to finalise negotiations before the EU Summit, which kicks off on Thursday. The positive impact on GBP will be a function of a) whether France or other EU countries sound unhappy with the terms and keep threatening to veto the deal; b) the content of the deal, especially when it comes to implications for the service sector. The most likely scenario in our view is that the deal will be a "skinny" one, mostly focusing on trade rather than services and leaving a certain degree of uncertainty for UK business. Should this be the case – and considering markets have maintained an optimistic stance on a deal - we may see cable's rally contained in the 1.37 region, and EUR/GBP running out of selling pressure below the 0.8900 mark. GDP and industrial output figures for October will be largely overshadowed by Brexit news.

AUD: Taking stock

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7420	Mildly Bullish	0.7370 - 0.7530	0.7300

- AUD/USD has continued to inch higher, largely on the back of USD weakness, but was outperformed by most of the G10 currencies in a week where investors largely rotated from conventional pro-cyclicals to the likes of EUR and CHF. The Reserve Bank of Australia meeting proved to be a non-event as it left the perceived and effective stance of the Bank unchanged. Better than expected GDP data proved interestingly supportive to the Australian recovery story, leaving us even more doubtful that the RBA will need to add further stimulus down the road.
- Next week will be a quiet one for AUD when it comes to domestic factors. The calendar does not include any market moving data and the speech by RBA Governor Philip Lowe may simply be a confirmation of his remarks from this week's parliamentary testimony. Overall, we expect the risk environment to stay supportive and USD weak, which should allow AUD/USD to test 0.75. Meanwhile, China allowed one coal cargo from Australia ashore this week: let's see if this is followed by more baby steps towards a de-escalation of trade tensions, which would add fuel to another leg higher in the Aussie dollar.

NZD: Signs that momentum is fading

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7040	Mildly Bullish	0.7000 - 0.7130	0.6900

- The Kiwi dollar staged only a marginal gain this week following a very strong month of November. We are not surprised considering that the positive impact of the re-pricing of negative-rate expectations has ended and that further upside for front-end rates is now very limited.
- There are no data releases worth mentioning nor central bank events next week in New Zealand, so NZD should continue to move in line with risk appetite. Accordingly, we could still see NZD/USD edge higher in the coming days, but NZD momentum appears to be fading (some long-squeezing may also get in the way), so we expect NZD to underperform its peers AUD and CAD next week.

CAD: Say goodbye to 1.30, and the BoC won't step in the way

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2830	Mildly Bearish ↘	1.2700 - 1.2900	1.2900

- Another above-consensus employment report today (+62k increase in hiring, unemployment rate dropping to 8.5% in November) offset the quite grim September GDP figures earlier in the week and fuelled hopes of a well-paced economic recovery in Canada. This contributed to the very good momentum in the Canadian dollar thanks to the general supportive risk sentiment and the positive oil reaction from OPEC+'s agreement on tapering cuts.
- USD/CAD has dropped below the 1.30 mark and the relatively solid fundamentals of the loonie, along with a continuation of the benign USD decline, suggest we may not see levels above 1.30 again in the next year or two. This coming week, the Bank of Canada's rate decision will be in focus, but we see very little room for surprise. The jump in employment in November is another factor which suggests the BoC does not need to expand its stimulus package (via rate cuts or more QE). At the same time, with lingering uncertainty about the timing for rolling out a vaccine, Governor Tiff Macklem is unlikely to sound too hawkish or upbeat on the recovery. The most preferable scenario for the BoC and the most likely to materialise in our view is for the meeting to go down as a non-event.

CHF: Has the SNB been busy?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0810	Mildly Bullish ↗	1.0780 - 1.0930	1.0900

- European event risk at the EU summit means it is going to be a big week for EUR/CHF. We're optimists and that's why we have a 1.0930 upper boundary to the EUR/CHF trading range. Failure to progress on the Recovery Fund or Brexit could set back EUR/CHF to 1.0680/700 – but that's not our call.
- The Swiss calendar is quiet ahead of the quarterly Swiss National Bank policy meeting on 17 December. But Monday sees Swiss November FX reserve data. A decent rise suggests the SNB might have been actively trying to hold USD/CHF above 0.90 – but that dollar selling proved too strong. A big increase in FX reserves should also be EUR supportive – given a big chunk of this activity (be it EUR buying or USD buying) should ultimately find its way into the EUR.

NOK: Data releases to have limited impact

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.6600	Neutral	10.5500 - 10.7700	10.7000

- Oil survived a quite tumultuous week among OPEC+ delays and disagreements, and this is good news to the highly exposed Norwegian krone, which remained on an appreciation path vs USD but has failed to outpace the EUR's big rally.
- Looking at the coming days, we have some hard data out of Norway: October GDP and November inflation. Of the two, inflation numbers are those more likely to have a market impact, though this should however be quite short-lived and contained considering the fairly consolidated expectations around the Norges Bank policy stance. Consensus is centred around a 1.7% YoY read, unchanged from October. External factors will remain dominant next week, with particular focus on Brexit, as a deal could boost the high-beta NOK.

SEK: Low inflation to keep SEK real rate attractive

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2500	Neutral	10.1900 - 10.3100	10.2000

- Similar to Norway, data releases will be the main highlight of the week for Sweden's krona. CPI numbers for November should fail to show convincing signs of a recovery in inflation, with the year-on-year gauges likely to stay close to zero. In the case of SEK, this should not be taken negatively given that a) the Riksbank just added monetary stimulus by expanding QE (which incidentally left SEK largely untouched); b) low inflation is putting a floor under the already attractive SEK real rate.
- SEK is set to be quite sensitive to events in Europe next week: Brexit, the EU summit (along with developments on the EU Recovery Fund) and the ECB meeting. The QE expansion from the ECB should broadly offset the extra stimulus deployed by the Riksbank last week, leaving the monetary implications for EUR/SEK largely unchanged.

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