G10 FX Week Ahead: Keep calm

Fears about the coronavirus in China may keep markets quite jittery next week, with the upside capped for cyclical currencies. The Bank of England won't, we think, cut rates, while the Fed meeting may go down as a non-event. Italian regional election may cause some noise, but we don't think the government will fall

Mark Carney, Governor of the Bank of England, will announce whether UK interest rates will be cut on Thursday

EUR: Stabilising eurozone data unlikely to translate into stronger euro

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1026	Mildly Bearish ↘	1.0980 - 1.1110	1.1000

- Eurozone data should confirm the Jan ECB meeting assessment of incoming data pointing to a stabilisation of growth dynamics and indications of a moderate increase in underlying inflation. German Jan IFO (Mon) is set to increase and core EZ Jan CPI (Fri) is to stay at 1.3%YoY. Still, as was the case after the ECB meeting, this does not mean a stronger euro as such as outcomes are (a) in line with ECB expectations, and thus (b) don't necessarily lead to a need to loosen policy stance. EUR attractive funding characteristics to remain intact.
- The key data event of the week is the Fed meeting (Wed). Following the easing of trade tensions, the Fed is to reiterate the message of stability in monetary policy for now. The largely unchanged message should not lead to either a material move in the dollar or a more meaningful repricing of the US rate path. The latter was recently more driven by the China virus-related concerns (which led to lower rates globally) rather than US specific considerations. With the Fed unlikely to induce a dovish repricing of the US curve (and thus softer USD) we continue to look for a broader EUR/USD stability with a modest bearish bias towards EUR/USD 1.1000.

JPY: Defcon4

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.38	Mildly Bearish ↘	109.00 - 110.00	110.00

- Risk markets are carefully monitoring the spread of the coronavirus. 2020 has so far been a good year for asset markets and the impact of the virus has largely been contained to Chinese markets. In the FX space, the JPY has shown a little out-performance on the crosses, but the FX options market is so far showing no real signs of alarm. We see USD/JPY nudging down to the 109.00 area, with Chinese markets being closed until Friday for the Lunar New Year perhaps limiting the fall-out on asset prices.
- We doubt the Fed will have too much impact on USD/JPY this week and, from the Japanese side, we'll receive updates on Tokyo CPI, Employment, Industrial Production and Retail Sales. At its recent meeting, the BoJ modestly upgraded growth and downgraded its inflation forecasts to leave its complicated monetary policy unchanged. It is hard to see BoJ policy having much impact on the JPY this year.

GBP: Close call but BoE to stay on hold

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3067	Mildly Bullish	1.2950 - 1.3280	1.3000

- The market is split on the odds of a Bank of England rate cut, pricing in a 50% probability of a cut. Although this has reduced from 70% prior to the better than expected UK PMIs on Friday, the pricing is still meaningful. Our economists expect the bank to err on the side of caution and to remain on hold. This is a close call with four MPC members possibly voting for the cut.
- This has two implications for GBP: (1) GBP is likely to appreciate in response to an on-hold decision, because of that 50% probability of a cut being priced in. (2) The scale of the GBP upside may not be pronounced as the uncertainty about the UK economic data and the tightest voting margin behind the BoE decision not to cut rates suggest that the market will continue pricing a non-negligible probability of a cut in coming months. So the market will postpone the expectations of the cut rather than fully reverse it. In the same way GBP reacted to the Jan UK PMI, sterling reaction to the on-hold decision may also be muted.

AUD: The rally looks overdone

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.6828	Mildly Bearish	0.6780 - 0.6880	0.6700

- This week saw markets slashing their expectations for 1Q monetary easing by the Reserve Bank of Australia. In only one week the pricing for the upcoming meeting (4 February) moved from -14bp to -4 bp. The trigger was an unexpected drop in unemployment from 5.2% to 5.1%. We think, however, that the market has been too hasty in pricing out easing. The jobs report was surely encouraging, but the employment gains were only driven by part-time hiring. Also, the unemployment rate is still too far from the level that would start to push up inflation.
- Speaking of inflation, CPI numbers for 4Q19 will be released on Wednesday and we expect them to flatten up at 1.7% (in line with consensus). This should prove an unexciting read considering the RBA target is at 2-3% and may cripple the upbeat mood on AU rate expectations. Markets may also start to reassess the fundamentals of such expectations and AUD may face some downside pressure next week, also considering the coronavirus story keeps sentiment in the region quite choppy.

NZD: Solid fundamentals, but risks from China

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6607	Neutral	0.6560 - 0.6660	0.6600

- This week, all pieces of data appear to have come together for NZD bulls (and for our constructive view on the currency). Inflation (at 1.9% in 4Q19) is an inch away from hitting the RBNZ target mid-point and we see no reasons for now why the Bank should feel uneasy with their current policy rate.
- More good news on the data front may come this week as trade numbers should reiterate the resilience of exports. In line with seasonal moves, the trade balance should move back in positive territory. In general, we do not see many catalysts in the near future able to dent the solid NZD fundamentals. At the moment, the downside risk for the currency is almost solely connected to the fears related to the outbreak of the coronavirus in China.

CAD: Higher sensitivity to data

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3141	Mildly Bullish	1.3100 - 1.3250	1.3100

- The Bank of Canada surprised the markets with a dovish shift, sending USD/CAD solidly back above 1.31. Now that a rate cut seems a more realistic option, attention to data releases is likely to be higher.
- November growth data, out on Friday, will therefore be watched very closely: the question is whether the MoM gauge will remain in negative territory. In terms of other drivers, the wind of risk aversion coming from China may keep on capping risky assets' gains, although CAD should be less exposed than the antipodeans.

CHF: Trouble from Italy?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0706	Neutral	1.0500 - 1.0800	1.0800

- Over the weekend, keep a close eye on regional elections in Emilia Romagna, Italy. A surprising win by the centre-right candidate will likely generate significant political noise and spur speculation that the governing coalition may break and new national elections are on the cards. As we highlighted in "Italy: Navigating the political waters", we don't think the government will fall imminently. With EUR/CHF acting as a proxy for Italian political risk, we think the pair will be the most affected (more than EUR/USD) by the event.
- In particular, the question remains to what level the SNB will allow the CHF to appreciate before intervening in the FX market. We think that markets may use Italian politics to test the SNB patience once again. If – as polls marginally suggest – the centre-left candidate wins, some political risk would be priced out from EUR/CHF that may enjoy a rebound towards the 1.08 region. However, the downside risk remains sizable, especially in the form of a possible knee-jerk reaction right after the regional election results and before the government steps in (as we think) and confirms its commitment to remain in power.

NOK: Retaining attractiveness

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.9628	Neutral	9.9000 - 10.0500	9.8000

- As we expected, the Norges Bank meeting left no marks on the market, with a message well in line with the December MPR. Looking ahead, we see a non-negligible probability of a hike later this year, in particular should NOK appreciation be contained and the economy continues to show signs of resilience. The attractive carry and cheap valuation keep the NOK an attractive option in the G10 space.
- Incidentally, January and February tend to be two seasonally favourable months for NOK appreciation. Next week, we'll have December retail sales as well as unemployment data, which are unlikely to materially derail NOK. Choppy risk sentiment may, however, keep the upside for the krone somewhat limited.

SEK: Still likely to lag other cyclical currencies

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.5480	Mildly Bullish	10.5000 - 10.6500	10.6000

- The few data release due next week in Sweden should prove only marginally impactful on SEK, with some possible attention only on retail sales, which may remain quite subdued. More interestingly, Eurozone data towards the end of the week which could potentially stir the pair due to the sensitivity of the Krona to European sentiment.
- Like any other high-beta currency, news on the coronavirus will determine most dynamics in the near future. Notwithstanding this, we note a still unattractive outlook for the krona, which should keep lagging its G10 cyclical FX peers, and continue to expect EUR/SEK dips below the 10.50 level to be shallow.

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Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com