G10 FX Week Ahead: Rose tinted glasses

Having seen risky assets survive the latest escalation in the US-China trade war, investors have rushed to cut long USD/short EM positions. And we've seen some substantial rallies in commodities too. However, were it not for the adjustment of long dollar positioning, we doubt markets would be looking so rosy. We're cautious on risk in the week ahead

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EUR: Big events, limited spillover

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1745	Neutral	1.1660 - 1.1820	1.1600

- The Federal Reserve's rate hike next week on Wednesday is all but a done deal. Rather the focus will be on any potential shift in the FOMC bias. In this respect, the key thing to watch would be any reference to the risks stemming from trade wars / emerging markets slowdown (as this would be dollar negative). Yet, we expect the FOMC to remain focused on the domestic situation and continue pointing to further tightening ahead. Also, note that two new hawkish FOMC members will be submitting to dots which should reiterate the current signal from the dotted diagram of three hikes next year. Overall, the interest rate forecast, GDP and CPI profiles should remain unchanged, meaning a fairly limited reaction in USD. 2Q GDP could be revised marginally higher, but this is unlikely to be enough to prompt a materially higher USD as two rate hikes are already priced in for this year and another two for 2019.
- In the Eurozone, we should see modest improvement in core inflation, rising to 1.1% on the back of labour market improvements and second-round effects of higher oil prices, with headline CPI staying at 2%. This shouldn't change the ECB current autopilot (with quantitative easing signalled to end by end of the year and the first depo hike to be delivered after summer 2018). Rather the EUR/USD price action should remain driven by technical positioning and stop losses next week. We look for EUR/USD to range trade around 1.1700 - and want to see how it trades on Tuesday/Wednesday when the Italian populist government submits its 2019 budget.

JPY: Pure Fed play

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	112.61	Mildly Bullish	111.80 - 113.10	112.00

- USD/JPY has notably withstood the broad capitulation of long dollar positioning – and it's easy to see why. The large early year US tax cut and aggressive repatriation of overseas earnings is helping US growth and the stock market. So the US risk environment looks very good indeed. US rates are also breaking to new cycle highs and on balance we see this week's Fed risks as dollar positive. The relatively flat yield curve and more expensive USD hedging costs are keeping USD/JPY bid.
- The Bank of Japan story remains on the back-burner, although Wednesday will see a press conference from BoJ Governor Haruhiko Kuroda as the latest BoJ minutes are released. We'll see the latest figures for industrial production – expected to pick up after a soft summer. So far the fall out from the global trade war hasn't been acute in Japan. Indeed BoJ statements continue to refer to a 'virtuous circle'. However, we should keep our eyes peeled for signs of declining export volumes and industrial production – warning of much slower trade growth into 2019.

GBP: Chequers mate!

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3070	Bearish ↘	1.2900 - 1.3150	1.3200

- Early week GBP optimism gave way to abject pessimism as it became clear that EU leaders hadn't budged an inch in their stance on Brexit. Prime minister Theresa May delivered a very blunt speech on Friday, where the phrase 'no deal is better than a bad deal' made a re-appearance. We doubt the tone lifts over the coming week, where PM May will continue to adopt a hard-line ahead of a Tory party conference which begins on 30th September. While we still feel a deal will be agreed, developments in Salzburg this week suggest negotiations will run right up to the wire – which potentially means late December since UK parliament would need a meaningful vote by 21st January 2019.
- Away from politics, we'll see a variety of Bank of England speakers this week including Mark Carney and Andy Haldane. The market struggles to see one full 25bp rate hike over the next twelve months and it's easy to see why. On the data front, we'll just see some CBI retail data and the 2Q18 current account data. This has narrowed a lot since Brexit, and our models suggest this has contributed to a slightly stronger fair value reading for GBP. That actually means GBP is even more under-valued at current levels.

CHF: The safe haven

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1267	Bearish ↘	1.1180 - 1.1320	1.1000

- The safe haven attractiveness of the franc remains in place. While the main driver behind the lower EUR/CHF in recent months was the political situation in Italy, this is now replaced by the Brexit uncertainty, with the CHF inversely matching the latest GBP sell-off. As per above, we don't look for the situation to improve next week ahead of the Conservative party conference, suggesting that the downside pressure on EUR/CHF is set to continue. We expect to see EUR/CHF break below the 1.1200 level next week.
- On the domestic data front, it's a very calm week after last week's Swiss national bank meeting. The usual focus is on the Sight deposit data due Monday and the September KOF leading indicator due Friday. however, all these data points should be secondary to the Brexit related sentiment.

SEK: All eyes on parliament

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3200	Mildly Bullish	10.2800 - 10.4200	9.6000

The Swedish parliament reconvenes on Monday for the first time since the inconclusive general election. Parties will try to vote on a new speaker, but there is also a risk of a no-confidence vote in the current centre-left government. Sweden will also get a first reading on the mood of businesses after the summer with the release of the economic tendency survey.

EUR/SEK has come sharply lower over recent weeks, helped in large part by a re-assessment of the Riksbank policy. This story may have run its course over the near term, and in the face of escalating trade wars and a dangerous turn in the Brexit mood, we wouldn't chase the EUR/SEK move any lower.

NOK: Stabilization after the disappointment

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5700	Mildly Bearish	9.5000 - 9.6150	9.5000

- After the surprising dovish hike from the Norges Bank and the subsequent NOK sell-off, we look for the krona to stabilise next week as the one-off adjustment is now behind us, while the rising oil prices (Brent oil breaking through the 80$/bbl level) should provide some support to NOK. The tentatively improving risk environment should also be supportive for high beta NOK.
- On the domestic data front, the market is focusing both on Governor Olsen and his two deputy governors speeches after the dovish hike, while the data flow (credit growth, retail sales, and unemployment) remains on the light side.

CAD: Still no progress on NAFTA

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2910	Neutral	1.2860 - 1.3070	1.2800

- We look for NAFTA negotiations to continue and while the bar for a deal between the US and Canada happening next week remains very high, we don't expect CAD negative news as the expectations for an immediate resolution aren't very high. This means that USD/CAD should remain driven by the general risk appetite where we look for a largely neutral environment following the risk rally this week.
- On the domestic data front, we look a minor uptick of 0.1% month on month in July's GDP print and a rise in July retail sales, from the -0.2% MoM downfall in June. None of this should have a material impact on Loonie following the surprisingly high July CPI print last month which led to a meaningful re-pricing of the market outlook for the Bank of Canada.

AUD: Copper bottomed

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7280	Mildly Bearish	0.7200 - 0.7300	0.7200

- The commodity complex is enjoying a resurgence, including an 8% rally in copper over the last week. The AUD has gone along for the ride and is challenging a big technical level at 0.7300 – which defines the bear trend since January. Long dollar positioning is probably the biggest friend for AUD/USD right now – although, on paper, the coming week presents many headwinds for AUD/USD. President Trump's $200bn of tariffs against China go into effect on Monday. Presumably, China retaliates immediately, and Washington threatens to slap tariffs on the remaining US imports from China. And dollar rates look firm to higher. The story as we see it, then, is whether 0.7300 holds or a short squeeze triggers a move to the 0.7360/80 area. We marginally prefer the former.
- Locally the data calendar is light, with just private sector credit growth released. Money markets show a pretty flat AUD curve out to one year, with 50bp of hikes in year two. It's hard to see that changing too much in the near term - but growing headwinds to global activity suggest those expectations could be cut.

NZD Bear market bounce

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6680	Mildly Bearish ↘	0.6620 - 0.6725	0.6500

- NZD/USD is enjoying one of its periodic bounces, largely on the back of liquidation of stretched long dollar positions. We struggle to see more of a re-assessment of the global environment at present, given no let-up in the trade war and no signs the Fed is prepared to slow the pace of tightening. We think this correction probably runs out of track in the 0.6725 area.
- The Reserve Bank of New Zealand has a meeting this week, and it looks likely it'll stick to the script of no rate change for two years with a symmetrical bias around a 1.75% policy rate. Both business and consumer confidence look fragile, and with China growth slowing, the chances of a more positive turn seem low. We'd like to have much more clarity on both protectionism and Fed policy, before declaring a major cycle low in NZD/USD.

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