G10 FX Week Ahead: Sizing the correction

FX markets this week will once again be fixated on the extent of the correction in global equities. Was last week's equity correction enough (probably not) and what will the next catalyst be?

Wednesday's US CPI to give risk assets a reprieve?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2267	Neutral	1.2125 - 1.2345	1.2300

- Trying to gauge the extent of the equity correction remains challenging, with price action remaining poor. Much focus will be given to the 200-day moving average in the S&P 500 at 2538. A big move through there, and a major spillover into other risk assets could prompt some kind of joint central bank communique that they stand ready to provide liquidity if needed. For EUR/USD, it now seems EUR/JPY correlation with risk is coming into play. We think the low 1.21s could be seen in EUR/USD in the early part of the week. However, softer US Jan CPI data on Wednesday, taking some pressure off the bond market, could give equities a reprieve - as could better retail US sales data - also on Wednesday.
- Eurozone data is pretty light this week, just clarification on 4Q17 GDP data (Wed) and some December industrial production data. We'll also be watching any news on the US fiscal side. Details on the infrastructure plan may emerge this week - whether this is seen as a positive (growth) or negative (fiscal burden) remains to be seen. An inverse correlation between the dollar and Treasury yields would be a worrying development.

Hedging US fiscal risk

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	108.59	Mildly bearish	107.50 - 109.20	110.00

- A holiday in Japan on Monday may be a welcome relief for the Nikkei and allow the US equity correction to blow itself out. Again, the 200-day moving average, 2100 for the Nikkei, will be a big level - below which volatility levels will certainly push even higher. The Japanese yen is the 'go-to' safe-haven currency given Japan's huge Net Foreign Asset position - thus USD/JPY downside is certainly possible in the early part of the week. Occasionally, Japanese authorities have intervened in equities - and that could be the case below 2100 in the Nikkei. Of course, all talk of 10-year Japanese government bonds breaking above 0.10% is gone.
- 107.00/107.50 is the bottom of a medium-term USD/JPY range, below which volatility levels could surge. We're starting to see some pretty large skews for USD/JPY puts (eg 2%+ in the 3m) and the inverted implied volatility curve warns of a sharp downside break-out if key levels are triggered. Given protectionist fears - any central bank support now has to be co-ordinated. Sub 105 levels on USD/JPY could prompt moves in that direction.

UK CPI data to reinforce BoE inflation concerns

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3835	Mildly bearish	1.3740 - 1.3950	1.4000

- With the Bank of England delivering what we call a Brexit-contingent hawkish signal, the next couple of weeks will all be about progress on a Brexit transition deal. Given that the road towards getting a deal is likely to mirror that of the divorce deal - in the sense of noise and difficult negotiations - we could easily see GBP crosses trade with a short-term risk premium until greater clarity. With the UK government unlikely to put forward its Brexit vision until late-February - and negotiations likely to be ongoing before the 22-23 March EU leaders summit, there will be little reason to see GBP upside.
- That said, our base case is that a transition deal will be agreed - and that talks will move towards a more amicable stage - meaning that any GBP downside could quickly be reversed on good Brexit news. Hence, GBP's sensitivity to Brexit-headline risks is not a one-way bet. GBP's sensitivity to UK data will also pick up after the Bank of England's hawkish message - this week's UK inflation data (Tuesday) will be key; our economists expect headline and core inflation to remain sticky (2.9% and 2.6% respectively) - reinforcing the Bank's latest inflation concerns.

Too much SNB tightening priced?

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1525	Mildly bearish	1.1490 - 1.1620	1.1700

- Persistent weakness in equities is keeping the Swiss franc bid and dragging EUR/CHF below presumed central bank intervention areas. The next such area in EUR/CHF would be 1.1400/1420 (late Sep lows). Driving the CHF move has also been a re-appraisal of SNB rate policy, where the December 19 EuroSwiss futures are now pricing 56bp of SNB tightening. Much further CHF strength and that tightening should come out. Our view this week of a little further equity weakness, but the 200-day moving average perhaps holding SPX at 2539, suggests CHF gains should start to slow - and perhaps reverse if soft US CPI can give US assets a break.
- Locally, January Swiss CPI is expected to remain at 0.8% year-over-year and give the SNB grounds to retain their dovish stance. SNB's Fritz Zurbuegg speaks on Wednesday and will probably again threaten FX intervention - saying the Swiss economy isn't yet ready for tighter conditions.

Riksbank to sound more hawkish

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	9.9300	Mildly bearish	9.8370 - 10.0300	9.6000

- We expect EUR/Swedish krona to stabilise following the sharp rise in the cross higher (briefly breaking the psychological 10.00 level) prompted by the global equity market sell-off. Should the risk environment stabilise (due in part to the expected lower US CPI reading, which could, in turn, tame the bond market decline) the heavily undervalued SEK should rebound.
- Domestically, the focus is on the Riksbank meeting (Wednesday). We expect the bank to retain its wait-and-see approach, though the risks are skewed to the marginally more hawkish tone following the recent SEK weakness and the strong global growth. The latter suggests a potential modest upward revision to the Riksbank's GDP forecast (following the BoE pattern last week). This could prompt a correction in EUR/SEK lower towards the 9.8400 level.

Oversold NOK due a recovery?

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.7629	Mildly bearish	9.6450 - 9.8790	9.5000

- It is a very calm week on the Norwegian data front with the Q1 Consumer confidence (Tuesday) and Jan Trade Balance (Thursday) unlikely to exert any effect on the krone.
- Rather, NOK will be primarily driven by the general risk environment and the way it spills over into the oil price. Last week, NOK suffered heavily due to the mix of equity markets and the oil price decline. Should the risk sentiment stabilise, EUR/NOK is set to decline from the current oversold levels.

Jobs data and RBA speakers to set the domestic tone

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7813	Mildly bearish	0.7700 - 0.7880	0.7800

- The Australian dollar has come under pressure from two fronts of late: (i) the global equity market sell-off and (ii) a mildly cautious RBA policy statement. We expect the fallout from the latter to be fairly muted, with the former - and the external global risk environment - being the key driver for AUD this week. Should the stock market correction extend - we think classic risk-off conditions will prevail and AUD would be an under-performer.
- Domestic data will play second fiddle this week but we do have the January jobs report (Thursday) to watch out for. Also to note will be comments by Governor Philip Lowe (Thursday) to Parliament - as well as a speech by RBA board member Luci Ellis (Monday).

NZ inflations expectations are increasingly important

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7253	Mildly bearish	0.7180 - 0.7320	0.7200

- The Reserve Bank of New Zealand meeting itself spurred little new news for markets, although we saw some de facto NZD jawboning (or at least a warning) from Deputy Governor John McDermott that sent the kiwi lower. The comment itself was that if the trade-weighted New Zealand dollar moved higher, then the RBNZ may start using different language around the currency (i.e. more cautionary talk). It does suggest some aversion to isolated NZD strength - hence the RBNZ is unlikely to be among those central banks at the front of the queue to hike rates.
- That being said, we do think it'll be the data that will ultimately determine the future for RBNZ policy and, in particular, the central bank has flagged inflation - as well as inflation expectations - data. That makes the 1Q RBNZ inflation expectations survey (Wednesday) quite pivotal. Any nascent signs of higher inflationary pressures could see some RBNZ rate hike sentiment come back online. Markets have all but pushed back odds of a 2018 hike since the RBNZ event (57% versus 48% prior) - meaning that there is scope for positive data to drive NZD rates and the kiwi higher. Other second-tier data this week include retail spending (Mon) and January business PMI (Thu).

USD/CAD looks to have overshot

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2577	Neutral	1.2500 - 1.2700	1.2400

- Despite a pretty negative headline Canadian jobs number (-88k), the realisation that this was largely due to part-time jobs and a particular area (Ontario) meant that the actual fallout in the Candian dollar was limited. We agree and don't think that the labour report will negatively impact on Bank of Canada policy tightening expectations. Markets continue to expect around a 65-70% chance of a rate hike in 2Q18 (30 May).
- Bar any negative NAFTA developments, a May BoC rate hike looks a certainty. The week ahead sees ADP payrolls data (Thursday), manufacturing sales and portfolio flows data (both Friday). External factors - sliding oil prices and the global equity market sell-off - are negatives for the high-beta CAD. A continuation of this environment would see USD/CAD gravitate higher, though given that this is an overshoot of intrinsic fair value - any stabilisation in the external environment could see a sharp correction lower towards 1.24-1.25.

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