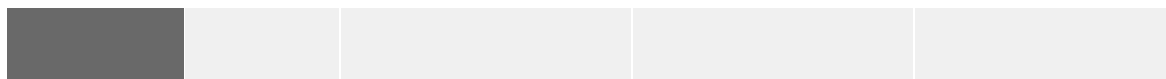


## G10 FX Week Ahead: State of the dollar

After last week's pick-up in FX volatility, this week also has plenty of inputs to the dollar story. President Trump's State of the Union speech on Tuesday evening has the potential to be less conciliatory than last week's Davos speech. This, rather than Wednesday's FOMC meeting, should be key for the risk environment in determining whether the short squeeze in the funding (and safe haven) currencies of JPY and CHF continues



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## State of the Union versus state of the Fed

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.2425	Neutral	1.2280 - 1.2540	1.2300

- The focus will turn to the President Trump's State of the Union address (Tue). The tone is likely to reflect the 'America First' theme, potentially (a) raising protectionist fears among market participants and (b) leading to speculation about a softer USD (as soft USD would be perceived as the go-to tool to improve US competitiveness). The widest monthly US trade deficit since July 2018 recorded in December further increases the risk of the US taking the path of a weaker USD (as per Treasury Secretary Steven Mnuchin's comments last week). To the extent to which this is reflected in a lower USD/JPY and potentially negatively affecting the general risk environment, EUR/USD may stay rather range bound. The Jan FOMC meeting (Wed) is likely to be a non-event, with the Fed just hiking last month. The January US job report (Fri) should show solid gains in nonfarm payrolls (170k), with wage growth remaining at 2.5%YoY. The impact on USD should be limited as this is close to market expectations while three full Fed funds rate hikes are already priced in for this year.
- German CPI (Tue) should edge higher to 1.8%, while Eurozone CPI should remain at 1.4% (yet core CPI should tick higher to 1% - both on Wed). Following the recent EUR/USD rally, we don't expect the EZ data this week to have a material effect on the cross. Rather the USD side will be the driver, suggesting modest upside risk to EUR/USD.

## BoJ normalisation fears overblown, protectionism real

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	108.80	Mildly bearish	107.00 - 109.80	111.00

- USD/JPY looks to be exposed on the downside this week, largely stemming from the high risk for the weak USD theme gaining further legs. As per above, President Trump's State of the Union address could be the next catalyst for it. Should the US desire a weaker USD, USD/JPY looks indeed vulnerable given the cross overvalued (albeit modestly) and the vastly differing current account positions.
- While we don't think that this is the time to position for the BoJ policy normalisation just yet, the recent Governor Haruhiko Kuroda comments about Japan being close to the 2% inflation target provide a fertile ground for such speculation. Indeed, today's retracement on the back of BoJ comments clarifying Kuroda's remarks, (i.e. Kuroda wasn't announcing any changes to the formal CPI forecast) has been very modest. For the USD/JPY, this week is about Trump's 'America First' policy and potentially additional speculation on the future BoJ stance rather than any domestic Japanese data (such as Dec IP on Tue). Range lows are seen in the 107.30/108.00 area, which we roughly expect to stay intact. Any move under 107.00 could prompt broader position adjustment given a speculative market short JPY.

## Carney happy to let the data do the talking

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.4135	Mildly Bullish 	1.4050 - 1.4350	1.4000

- Bank of England Governor Mark Carney's testimony to UK parliament (Tue) will be the focal point for markets ahead of the February BoE meeting. The positive jobs and 4Q UK GDP data surprise certainly put upside risks to the Bank's economic outlook - though we think the Governor may toe a neutral line until clearer evidence of economic resilience in the data. Indeed, the MPC's approach has been to let the data do the talking - especially while Brexit sentiment continues to ebb and flow.
- Second-tier data releases this week include BoE monetary stats (Tue), consumer confidence (Wed) and Jan manufacturing PMI (Thu). The latter will give the first indication of how the UK economy is performing post the Brexit Divorce Deal (and whether sentiment could potentially pick up). Look for GBP/USD to consolidate in a fairly noisy weak for US politics.

## Caught up in the currency funding squeeze

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1625	Mildly bearish	1.1570 - 1.1680	1.1700

- The Swiss franc has been showing some genuine out-performance - probably because a weak dollar sent USD/CHF through 0.9420 (2017 low) at the start of the year. Is this the start of a new trend, ie higher oil prices dragging all central bankers - including the BoJ and SNB - to consider normalisation policies - generating both a stronger JPY and CHF? Conversely the decline in USD/CHF will be making the CHF trade-weighted look stronger and the SNB more likely to intervene in EUR/CHF. That intervention is probably expected in the 1.1550/1580 area - if not, CHF could rally even further against the USD. Certainly we see downside risks to USD/CHF this week.
- In terms of local data, the focus will be on what should be a strong KOF (Tues) and PMI (Thurs). Also Wednesday's release of the SNB's 4Q17 FX reserve mix will be interesting. The SNB is seen as one of the more pro-active FX reserve managers and any sign that it's cutting its USD allocations (35% 3Q17) could add to the sense that buy-side investors are looking to cut USD exposure medium term.

## Australian CPI release unlikely to accelerate tightening

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.8085	Mildly bearish	0.7900 - 0.8150	0.7800

- The weak dollar environment has been the key driver for AUD/USD - taking the pair meaningfully above the 0.8000 level. Notably, iron ore prices stayed in the \$70-75/t range - despite the fear of Trump steel tariffs. The President's State of the Union speech (Tue) will be important here - and there is the tail risk of Trump using this stage to employ active protectionist policies. In this environment, it would be difficult to see anything but AUD tracking iron ore prices lower.
- The calendar this week sees 4Q Australian CPI (Wed) - which will be a focal point for domestic markets. The consensus is for the headline figure hitting 2% YoY - though the trimmed mean only at 1.9% YoY. The latter would still be below the RBA's 2-3% target range - and in the absence of any positive surprises, it is unlikely that we'll see a shift in sentiment towards an earlier RBA rate hike. Markets still see a 2018 RBA hike as an unlikely outcome - and recent AUD strength may also keep the RBA on the more dovish side for now.

## CPI miss has taken some steam out of NZD

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.7325	Mildly bearish	0.7200 - 0.7440	0.7200

- After the significant 4Q NZ CPI miss (headline 1.6% YoY vs. 1.9% expected) that took the New Zealand dollar off its recent highs, the domestic story is fairly quiet this week - with only trade data (Mon) to note. On the inflation story, it's worth pointing out that the central bank's sectoral factor inflation estimate - the equivalent of core - stayed the same at 1.4% YoY. So, the knee-jerk NZD move lower may have been a slight overreaction - although we don't expect any domestic (non US dollar) reasons for NZD/USD to move higher.
- The external environment will be a key factor for NZD/USD. Were we to get a marked shift in risk-off, there's a chance that the high-beta NZD could be vulnerable.

## Canadian activity data to help cement expectations of May hike

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2347	Mildly Bullish 	1.2250 - 1.2450	1.2400

- NAFTA negotiations have been a sideshow in light of all the 'weak dollar' policy talk by US officials. Nonetheless, it was reported - at least from the Canadian perspective - that the latest round of talks has been progressive. NAFTA may be a big part of Trump's State of the Union address (Tue) - and any negative tone could weigh on the Canadian dollar. But against a weak dollar backdrop - and general Trump 'all talk but no action' sentiment - the fallout may be limited.
- With Canadian CPI printing broadly in line with expectations - and core inflation readings in fact nudging higher - the focus will be on activity data now to determine the timing of the BoC's next rate hike. The week ahead sees Nov GDP (Wed) and Jan manufacturing PMI data (Thu); positive surprises could reinforce the current sentiment around a May BoC rate hike (currently a 78% probability is priced into the CAD OIS curve). Oil prices continue to remain supported, though we note Western Canada prices have again become disconnected with WTI (potentially NAFTA related). As such, oil may itself not be too much of driver for CAD in the near-term.

## SEK to continue under-performing NOK

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	9.7800	Neutral	9.7345 - 9.8570	9.6000

- In the soft USD environment, the Swedish krona is poised to continue underperforming the Norwegian krone as it is not exposed to the higher oil price, while the strengthening trade-weighted currency (in part due to the softer USD) has historically been a bigger issue for the Riksbank rather than Norges Bank.
- We expect EUR/SEK to trade modestly below 9.8000 partly caused by another solid Swedish PMI Manufacturing reading.

## NOK enjoying the softer dollar scenario

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5590	Mildly bearish	9.4920 - 9.6560	9.6000

- The general soft dollar environment is pushing commodities and oil prices higher, in turn directly benefiting NOK. NOK is current in the sweet-spot in European FX. As other European currencies, it benefits from higher EUR/USD but unlike others, it also has an exposure to the higher oil price.
- With the NB looking at and determining its interest rate forecast rather mechanically, the persistently high/er oil price increases the odds of another upgrade (albeit modest) to the NB rate forecast at the next meeting. The likely solid Norway Jan PMI (Fri) should add support to NOK. 200-day MA of EUR/NOK 9.4920 to act as a support this week.

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