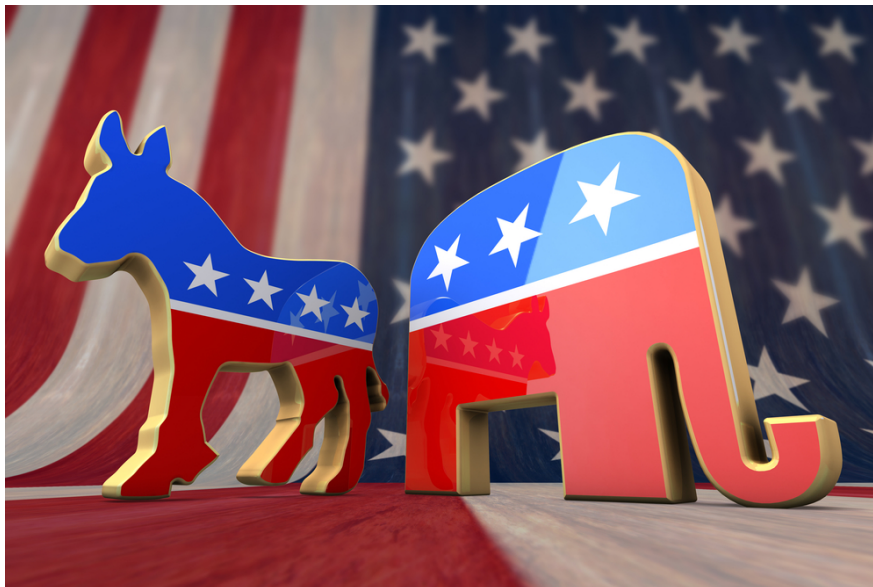
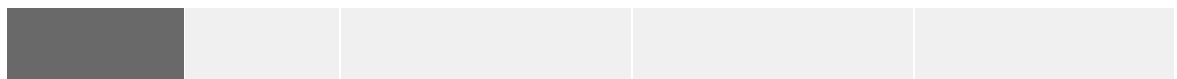


G10 FX Week Ahead: Surfing the mid-term wave – be it Blue or Red

Tuesday's US mid-term elections are going to set the dollar trend for the remainder of the year. Pollsters confidently predict the Democrats taking the House – probably a small dollar negative. But pollsters have been wrong before!



Source: Shutterstock




EUR: Mid-terms should set the trend

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1380	Mildly Bearish 	1.1300 - 1.1510	1.1400

- Tuesday's mid-term elections will have a major say over where the dollar trades for the rest of the year. Long dollar/short EM positioning is vulnerable going into this election risk given that in the background we now have the (albeit small) prospect of Presidents Trump and Xi striking a trade deal later in November. But the dollar hasn't rallied this year purely on trade friction. The fiscal/monetary mix has had a big say in the dollar, and that's why mid-terms are important. Pollsters expect the House to go to the Democrats, which reduce chances of fresh stimulus, raise chances of debt ceiling grid-lock and probably be slightly dollar negative. A Red Wave of a Republican hold in Congress is unexpected and would probably be dollar bullish. The coming week will also see a Federal Reserve meeting, where growth is strong, inflation is at/or above target, and further gradual hikes are deemed necessary.
- Europe is trying to understand what went wrong in 3Q18. Growth disappointed at 0.2% quarter on quarter and confidence is low that the poor result was a one-off. German industrial production and retail sales for September may shed some light here. We'll also see more PMI data across the region, but the recent release of flat Italian GDP in 3Q18 and another manufacturing PMI below 50 creates a fertile ground for further budgetary conflict between Rome and Brussels. If there is a EUR/USD short squeeze on the mid-terms, we think it could stall before the 1.1560/1620 resistance area.

JPY: Peak earnings?

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	113.15	Mildly Bullish 	112.00 - 113.80	113.00

- USD/JPY correlation with US equities has actually been picking up recently – again suggesting that the mid-terms and what they mean for equity markets will set the tone. While it seems hard to repeat the 25% YoY growth in corporate earnings seen through this current earnings season in the US, we probably have to see much clearer signs of a slowdown or much higher Treasury yields to trigger a deeper corrections in equities. Our base case of the US economy moving into late cycle next year, including a gentle flattening of the US yield curve, keeps us mildly bullish \$/JPY for the time being.
- In Japan, last week the central bank cut their GDP and CPI forecasts and look unlikely to tinker with monetary policy ahead of the October 2019 VAT hike. Data out from Japan this week should see a healthy current account surplus and some positive cash earnings, supportive of the virtuous cycle of exports, corporate profits and employment. Global equity investors like Japan right now, but get paid to hedge JPY FX exposure. That's why this story isn't helping the yen.

GBP: The up and down of Brexit

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2965	Neutral	1.2850 - 1.3150	1.3000

- The ebb and flow of Brexit continue to drive GBP and UK rates. After a bad October, (GBP short-term rates priced three years forward fell 30bp during the first three weeks of October), we see something of a reprieve. Remarks that we'll see a Brexit deal by November 21st have helped, although the UK press story that an equivalence deal for financial services has been agreed looks over-hyped. Cable has now swung into the upper half of the 1.27-1.32 trading range, and frankly, there is not much certainty we can push a lot higher. That said, further remarks from Brussels that they may be compromising their position on the need for a back-stop on the Irish border could trigger some modest GBP gains.
- The UK data focus next week will be Thursday's 3Q18 GDP release. Consensus already expects a strong 0.6% QoQ and UK rates have already risen after the central bank press conference. Unless we see a 0.7% QoQ print or higher, it will be difficult to see GBP/\$ push onto the 1.3250/3300 area. However, we are becoming more bearish on the EUR, and for those expecting sterling to perform a little better, we could see EUR/GBP trading down to 0.8620.

AUD: The central bank takes it easy

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7192	Bearish 	0.7150 - 0.7300	0.6900

- Tuesday's RBA meeting will be the highlight of the week, followed closely by China trade data for October. On the former, no one is expecting any change in the neutral/dovish rhetoric and the market still does not price the first RBA hike in the cash rate (currently 1.50%) until next May. Activity data has been holding up reasonably well, although the RBA seems in no hurry to normalise policy.
- The market is a little concerned about downside risks to China export data, in the case of front-loading before US tariffs went into effect this summer. The AUD was a big beneficiary of President Trump's suggestion of a trade deal with China – and his rhetoric will be closely tracked post the mid-term results. Certainly, a trade deal with China is not priced into the AUD – and we would be very careful about doing so.

NZD: No reason to be less dovish

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6643	Mildly Bearish 	0.6550 - 0.6700	0.6400

- The Reserve bank of New Zealand meets on Wednesday for the first time since their very dovish August meeting. Back then, the RBNZ pushed out its first expected hike into 2020, sending local yields and the NZD lower. Its statements continue to be very equivocal on rates, with balanced risks providing little insights as to whether the next move is up or down. Given the uncertain trade environment and clear signs of China slowing, the RBNZ looks right to be cautious.
- Beyond the RBNZ, we'll also see, 3Q employment data. Consensus expects this to fall to 2% YoY, the lowest since early 2015 and perhaps fanning RBNZ fears that labour market constraints are beginning to bite. On balance, we think it's too early to expect anything other than a modest correction in an underlying NZD/USD bear trend.

CAD: Underperforming other commodity currencies in the case of risk rebound

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3110	Neutral	1.3020 - 1.3200	1.3000

- The data calendar in Canada is very calm next week, which suggests that the primarily driver of USD/CAD will be the US dollar and the market response to the US mid-terms. Even if there is some knee-jerk modest USD softening (as a probability of another fiscal stimulus gets priced out in the case of Republicans losing the House), we expect the CAD to lag other G10 commodity currencies (namely AUD and NZD) as the prospect of less strong US growth would be relatively more negative for CAD (given its trade links with the US) vs the rest of the G10 currencies.
- Based on our short-term financial fair value model, we don't see any material short-term mispricing in USD/CAD and consider the Friday's correction in USD/CAD higher as fair.

CHF: Surprisingly calm

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1417	Mildly Bearish ↘	1.1370 - 1.1470	1.1200


- EUR/CHF continues to be relatively agnostic to developments in Italy, although has edged higher recently as BTP-Bund spreads have narrowed. Of note over the last week has been the Swiss central bank's releases of FX reserve allocation trends, showing a modest increase in the share allocated to the USD, at the expense of the EUR and GBP. That makes sense – at least in terms of available yield.
- There's not a lot of Swiss data to focus on, and instead, factors like Italy and US equities will be in focus. Both of these could flare up at any time and combined with some soft Eurozone data readings suggest there's little reason to chase EUR/CHF higher near term. On the Italian side, soft activity data in Italy will keep Rome dug in on the need for fiscal expansion. Brussels and Frankfurt seem dug in on the need to play by the Maastricht rules.

NOK: Higher CPI offset by lower oil price

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5270	Neutral	9.4620 - 9.5650	9.5000

- In Norway, the October inflation reading due Friday is a key data point. Our economists continue to see upside risk to the Norges Bank's inflation forecast but expect the bank to reiterate its intention to keep rate increases gradual - by which it means a pace of two hikes per year. A solid CPI reading next Friday could be marginally NOK supportive (headline CPI expected at 3.4%), but the recent decline in the oil price is taming NOK's upside.
- The latter has recently led to NOK underperforming the SEK. Both are high beta currencies, but the recent decline in oil prices is disadvantageous to the Norwegian krone. While NOK/SEK may break below the 1.0800 next week, we would see the dip as a buying opportunity as the anticipated seasonal year-end SEK weakness should translate into higher NOK/SEK, towards the 1.100 level. For EUR/NOK, the 200-day moving average of 9.5650 is currently acting as a solid resistance.

SEK: No new clues coming from the Riskbank

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3130	Bearish 	10.2650 - 10.3930	10.6000

- The Riksbank remains non-committal on the exact timing of the first rate hike (the minutes from the October meeting did not reveal whether the hike will come in December or February) and we don't expect the speeches from the various board members to deliver a different message next week. This, in turn, suggests that a potential effect on SEK of either positive or negative Riksbank surprise in terms of its rate guidance continues to be further postponed, with EUR/SEK to remain driven by external risk environment. As per above, the outcome of the US elections might be marginally risk positive if it leads to somewhat softer USD and limits upside to UST yields by decreasing probability of another fiscal stimulus. This in turn can lead to EUR/SEK briefly dipping below the 10.30 level again next week.
- Elsewhere on the domestic data front, we are likely to see some rebound in September industrial production due Tuesday following stronger PMIs, while the October average house price due Thursday should continue declining.

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