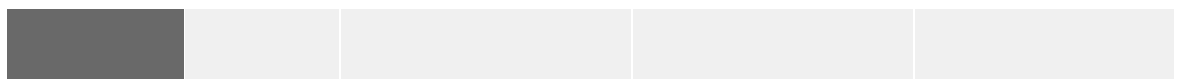


## G10 FX Week Ahead: Trade War, Huh, Yeah, What is it good for...

...absolutely nothing. The threat of a global trade war has moved to DEFCON 4 after major trading partners chose to retaliate against the US administration, broadening out steel and aluminium import tariffs. This will dominate the market narrative - especially after a fairly 'goldilocks' jobs report failed to help the USD break higher




## EUR: The worst seems to be over

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1680	Neutral	1.1600 - 1.1840	1.1700

- We suspect the euro/US dollar has seen its bottom at 1.1510 and is unlikely to re-test it in the coming week. With the Italian political situation stabilising, the eurozone risk premium should now be less of a negative driver of EUR/USD (the risk premium has already narrowed from 4% on Tuesday to 2.5% currently). The euro should obtain some support from the forthcoming domestic economic data. Following the solid German IFO and eurozone CPI over the past two weeks, the eurozone April retail sales (Tuesday) and the batch of German industrial data should point to a rebound of the economy in the second quarter and in turn support the euro.
- On the US data front, and following the strong May US labour market report, the focus turns to May ISM non-manufacturing (Tuesday) which should be solid too. But generally, the larger emphasis will be on the escalating trade wars and forthcoming signs of the eurozone retaliation, in response to the US imposed tariffs on eurozone steel and aluminium imports to the US.

## JPY: Don't read too much into the BoJ decision to cut JGB purchases

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	109.60	Bearish 	108.40 - 110.80	109.00

- USD/Japanese yen should break above the 110.00 level as the likely sustained increase in US Treasury yields (the strong May US labour market report should be followed by solid ISM non-manufacturing) is positive for USD/JPY. However, the scope for a large upside to the cross should be capped by the ever-present risk of global trade wars.
- On the domestic data front, the focus is on May PMI Services (Tuesday). The final 1Q GDP (Friday) may show an improvement from the previous negative reading but should have a limited impact on the yen. We don't read too much into the Bank of Japan decision to cut purchases of Japanese government bonds as this was likely done as a response to the very low yields (hence less need to intervene) rather than being an indication of a policy shift. Recall the BoJ is a yield targeter.

## GBP: Renewed focus on Brexit politics may keep investors cautious

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3310	Neutral	1.3200 - 1.3450	1.3400

- Although more recent GBP-specific ebbs and flows have been driven by the sharp re-pricing of Bank of England policy expectations, we expect the focus for the pound over summer to shift back to Brexit politics, ahead of a crucial Commons Withdrawal Bill vote (TBC) and the 28-29 June EU leaders' summit. While Brexit risks remain just noise at this stage, we have some sympathy for investors wanting to shy away from GBP until there is clear political clarity. The improbability of this occurring in the near-term may keep GBP bullish sentiment at bay – and points to a more shallow recovery.
- Aside from the renewed focus on politics, the May construction (Monday) and services (Tuesday) PMI readings will command some attention. The bounce back in the manufacturing PMI injected some positive sentiment; we would expect the same if the rest of the PMI releases show a similar feat. A tricky summer of Brexit politics may lie ahead, but the pound still remains a good value play - with BoE tightening the channel through which GBP's valuation gains get realised. We look for sterling to navigate towards levels consistent with a 'neutral' Brexit by year-end (GBP/USD at 1.45).

## AUD: Caught in the crossfires of US trade policy

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7530	Neutral	0.7450 - 0.7620	0.7600

- The June Reserve Bank of Australia meeting (Tuesday) is set to be a non-event; data since the May meeting has been fairly mixed - with decent jobs growth offset by softer wage growth and disappointing 1Q private capex data. We expect the statement to remain broadly unchanged - especially on the policy outlook, which lends itself to a muted reaction in AUD markets. We suspect the domestic focus instead be on 1Q Australian GDP release (Wednesday); markets are looking for a strong bounce back in quarterly growth (+0.8% quarter-on-quarter vs. 0.4%) - though much of this may be base effects due to a soft 4Q17 outcome. Other data releases to note include April retail sales (Monday) and April trade data (Thursday).
- Aside from a busy local week, the broader driver for AUD will be the secondary effects of US trade policy on global risk sentiment. A nervous market environment may keep a lid on the Australian dollar - although we note that the currency could quickly break higher on any easing (or lack of escalation) in tensions.

## NZD: A haven amid geopolitical uncertainties

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6975	Mildly Bullish 	0.6880 - 0.7100	0.7100

- The domestic scene is fairly quiet in the week ahead - with only second-tier data releases to only note (QV house price data). The Reserve Bank of New Zealand's Financial Stability report struck a fairly constructive tone - noting reduced systemic risks from the housing market, while credit growth is also expected to slow. Counterintuitively, this may be good news for NZD markets - as easing house price inflation could reduce the tail risk of a bubble bust and may give the central bank greater confidence over tightening at some point.
- Should this be a turning point for the USD, then we think NZD/USD could be one of the outperforming pairs; the kiwi's relative performance against the G10 commodity currencies since mid-April suggests it looks oversold, while it is less directly exposed to a more protectionist US administration. We think there is room for further tactical upside in the NZD - supported by resilient domestic fundamentals and favourable terms of trade.

## CAD: Optimism dented by rising US-Canada trade frictions

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2955	Neutral	1.2800 - 1.3130	1.2800

- While the Bank of Canada (BoC) sent a strong enough conditional signal for a July rate hike, US trade policy is a major headwind for the Canadian dollar (CAD) right now - in effect making domestic data and the central bank tightening story a redundant factor. The Trump administration's decision to impose steel and aluminium tariffs on Canada - and not extend exemptions - was a clear escalation in US-Canada trade frictions and resulted in Prime Minister Justin Trudeau instating retaliatory 'dollar for dollar' tariffs. More broadly, these events put a big question mark over the future of Nafta (note Mexico has also chosen to retaliate against US tariffs). Reports that President Trump pulled the plug on a 'win-win-win' Nafta deal earlier in May - after insisting that some form of sunset clause needs to be included (which both Canada and Mexico have profusely objected to) - means that it's difficult to see a near-term resolution. Extending this sentiment to CAD, it's hard to see the currency trading materially higher given ongoing trade uncertainty.
- The May BoC policy statement gave a sufficient enough conditional signal for a July rate hike - though we stipulate that this is conditional on resilient incoming data, Nafta break-up risks staying low and global market jitters easing. The latter two factors keep us most nervous over the prospects of BoC rate hikes - and make the already 50bps worth of tightening this year in the OIS curve a major risk to CAD. Expect USD/CAD to stay neutral below the 1.30 handle - with risks of a topside breakout towards 1.32-1.33 increasing.

## CHF: Stabilising after the Italian-induced rally

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1560	Bearish 	1.1500 - 1.1600	1.1700

- Italian political risk has taken its toll on euro/Swiss franc, triggering a brief move below 1.15. Swiss sight deposits released on Monday will be an interesting read, perhaps demonstrating that the Swiss National Bank has been intervening below 1.15 – FX intervention being part of the monetary policy toolkit. If some of the 4% risk premium can leave the EUR, EUR/CHF should be able to slowly climb to the 1.17 area.
- Wednesday sees the release of Swiss CPI data for May. There are probably upside risks to the consensus figure of 0.9% year-on-year, given higher oil prices and their impact on eurozone CPI data. We'll also be looking out for any clues on voting intentions in the Swiss Vollgeld referendum next weekend. Recall a 'Yes' vote could potentially re-wire the whole Swiss banking system and in the first instance be very negative for the Swiss franc.

## SEK: Constrained by global trade wars

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3000	Neutral	10.2000 - 10.3620	10.5000

- The price action during the first two days of the week (the peak of the Italian political crisis) clearly underscored the Swedish krona's vulnerability to the deteriorating general risk appetite, with SEK being the weakest G10 currency by a large margin. Now, with the risk of escalating trade wars being fully in place (the US imposed steel and aluminium tariffs on the eurozone, and the eurozone is to retaliate), there seems to be little catalyst for SEK gains against the euro next week.
- The upside risks to SEK are unlikely to be delivered by the Riksbank either where governor Stefan Ingves reiterated that monetary policy needs to continue to be expansionary. The speech by Riksbank deputy governor Jochnick (Thursday) is of interest as she forms the part of the dovish majority. We look for EUR/SEK to remain flat around 10.30.

## NOK: In limbo

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5380	Bearish 	9.4600 - 9.6120	9.4500

- It's a very quiet week on the Norwegian data front (April Industrial production on Thursday), suggesting rather calm euro/Norwegian krone trading. The stabilisation of oil prices and partial reversal of the previous week's losses is also supportive of NOK.
- Should concerns about global trade wars increase, this would pose some upside risk to EUR/NOK, yet NOK is to outperform SEK (given the lower degree of openness of its economy vs Sweden). The 200-day moving average of EUR/NOK 9.6120 acts a strong resistance against more pronounced NOK weakness next week

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