G10 FX Week Ahead: Whatever it takes, again

Central banks and governments appear ready to do “whatever it takes” (to quote a famous speech by Mario Draghi) to mitigate the Covid-19 shock, but they still appear unable to revive risk appetite. It's unclear whether the ECB will follow the Fed with rate cuts and we see the dollar staying under pressure

Source: Shutterstock

DXY: How low can the Fed go?

	Spot	Week ahead bias	Range next week	1 month target
DXY	96.0000	Bearish ↘	94.4000 - 96.5000	95.0000

- The global flight to safety looks set to continue, which sees core bond yields collapse, credit spreads widen and now the dollar lose its defensive status. We assume that equity markets remain under pressure for the month of March as investors monitor the growing spread of Covid-19 and re-price the global growth outlook. One of the key issues is how far the Fed cuts rates. The Fed won't want to be dragged into supporting the stock market on a frequent basis and will want fiscal stimulus to play its part. However, it will be hard for the Fed to under-deliver on the 50bp+ of easing now priced for the 18 March meeting, which would take the Fed's target range to 0.50-0.75%. That's not too far away from the Fed's lower bound and expectations of a fresh round of QE have now started to weigh on the dollar. In theory it's the black-out week for the Fed ahead of the 18 March meeting, but we would not be surprised to see hastily arranged congressional testimony from Fed Chair Powell this week – offering the Fed's support.

- As we've seen with the reaction to the NFP data, markets are looking forward at equity markets and not backwards at activity or price data. So NFIB, CPI, and further Democratic primaries look unlikely to play a role in FX pricing next week. We will though expect the White House to be ready to offer assistance – perhaps by re-allocating some emergency FEMA funds, should Congress permit.

EUR: ECB will have to suffer a stronger Euro

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1300	Mildly Bullish	1.1200 - 1.1500	1.1500

- EUR/USD has just seen its single biggest weekly jump since 2016, largely as a result of surging volatility triggering covering of short EUR positions and also now the view that the Fed might have to contemplate renewed QE. The week ahead will see focus on the ECB's response. It looks like the ECB didn't want to play ball with a co-ordinated rate cut – genuinely believing lower rates would do more harm than good. This puts it in a tricky spot for next week's ECB meeting. We think it wants to avoid a rate cut and instead will be looking at targeted measures to support corporate and SME lending, e.g. a TLTRO targeting the corporate sector. The lack of a 'bazooka' from the ECB may add to pessimism in risk assets (and pressure on the Fed to do the heavy-lifting with easing) and keep EUR/USD bid.
- Again we doubt that data will have much bearing at all on the FX markets. Instead investors will now also be focusing on the politicians. Do they passively allow fiscal stimulus by suspending budget rules in a slowdown or actively pursue spending to fill a hole in domestic demand? We expect 1.12 to prove good EUR/$ support now.

JPY: The battle line is drawn at 105

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	105.40	Bearish	104.50 - 106.50	105.00

- The JPY has emerged as the stand-out safe haven currency – largely as the pro-active Fed has undermined the dollar. Not until the market sees the number of new Covid-19 cases plateauing or some aggressive fiscal stimulus can we expect equity markets to find a floor. We thus see risk assets staying under pressure through March. For USD/JPY, strong support at 105 is under pressure. Traditionally the Japanese MoF would have instructed the BoJ to intervene to buy FX. Now, however, the White House is very wary of currency manipulation. Instead we think the semi-official GPIF may see value in unhedged US Treasury purchases under 105 – which would achieve the same end as FX intervention
- The BoJ is currently buying more assets (JGBs and stock ETFs) as part of its existing QQE scheme. We doubt it will be looking at rate cuts, given that local banking system profitability is under pressure. We suspect, however, any bounce in USD/JPY may be limited over coming weeks and months as the Fed considers easier policy and Japan can only look at methods to slow, not reverse the strong JPY trend.

GBP: Eyes on the budget

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3020	Neutral	1.2870 - 1.3130	1.2700

- Cable is back at 1.30 thanks to a combination of weak USD and abating speculation around a Fed-style emergency cut by the Bank of England. Markets now seem quite comfortable with the idea that Andrew Bailey will deliver a 25bp rate cut at his first meeting as BoE Governor on 26 March (which is also our base case).
- Next week, the big challenge for the pound will be the release of the UK budget. After the Cabinet reshuffle in mid-February, markets had put sizeable hopes that new Chancellor Rishi Sunak would have carried forward more aggressive fiscal stimulus. The spread of Covid-19 (albeit still relatively limited for now in the UK) has triggered a fiscal response worldwide and the UK government will likely follow with some targeted measures to curb the impact of the virus on firms. The fiscal stimulus side may therefore be partly outshadowed and we do not see the budget release providing sustained support to the pound. The other key driver of the currency in a longer-term perspective is the UK-EU trade negotiations which, in our view, will drive down GBP in the coming months. For now, a weak dollar should mitigate any negative stemming from possible market disappointment when it comes to fiscal stimulus expectations and GBP/USD may keep hovering around the 1.30 area.

AUD: Not at the bottom yet

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.6645	Bearish	0.6490 - 0.6665	0.6400

- The 25bp rate cut by the RBA failed to dampen the AUD given the market's even more dovish expectations. The bounce in equities on Wednesday did not translate into a material recovery in AUD, leaving it vulnerable to the most recent revamp in risk aversion. This may continue to be the key narrative for the next week: bleak rebounds in equities unable to lift the AUD, which remains highly vulnerable to the downside. No data releases in the calendar likely to have a material impact on AUD or RBA rate expectations next week.
- We have recently updated our forecasts: we expect one more 25bp cut by the RBA in April. This would bring the Cash Rate to 0.25%, the level indicated by Governor Lowe to consider unorthodox monetary policy. We think markets will price some form of quantitative easing which may add woes to the AUD, but we do not have QE as our base case and we expect those expectations to fade in 3Q, when we expect to see AUD rebound. We look for AUD/USD at 0.70 at the year-end.

NZD: The start of the AUD/NZD downtrend

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6366	Bearish	0.6235 - 0.6410	0.6200

- The bounce in the Kiwi $ seen today was largely connected with a drop in AUD/NZD after the disappointing Australia retail sales. Incidentally, markets are likely starting to see more limited downside risk to the NZD compared to AUD (mostly when it comes to the economic impact of the Covid-19 in the two economies).
- Next week will be quite dry in terms of data and NZD will remain driven by global sentiment which, once again, may prove detrimental for procyclical currencies. However, markets have moved to a quite aggressive easing stance on the Reserve Bank of New Zealand, pricing in 42bp of easing at the 25 March meeting and 60bp by the end of 2Q20. We suspect such expectations are overdone and we think the relatively strong fundamentals will allow the RBNZ to keep their rate cuts confined to 25bp for the foreseeable future. This assists our view that the NZD should outperform AUD in the next weeks, despite still facing downside risk against other major currencies on the back of Covid-19 fears and equity underperformance. We expect a move to or below the 1.03 level in AUD/NZD in the next weeks.

CAD: Eyeing a move to 1.36/1.37

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3425	Bullish	1.3200 - 1.3630	1.3700

- The loonie was the only G10 currency unable to outperform the dollar this week due to a combination of the Bank of Canada 50bp cut, lack of rebound in oil prices after OPEC+ cuts and mixed labour data. We suspect there is still some room for USD/CAD appreciation as market sentiment remains unsupportive. And this does not only bode ill for CAD due to the currency's high beta, but also as it prompts markets to keep looking for Fed easing and therefore on BoC easing on the back of the perceived coordination between the two central banks.
- Next week's calendar in Canada is mostly about housing data and should offer little inspiration when it comes to market impact. Inevitably, CAD will remain driven by the above-mentioned drivers and we currently eye a move in USD/CAD to the 1.36/1.37 region in the near future.

CHF: SNB easing expectations mount

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0578	Mildly Bearish	1.0500 - 1.0660	1.0500

- Foreign currency reserves at the Swiss National Bank jumped to CHF769bn in February from CHF764bn in January, confirming the generalized notion that the Bank has been quite active in recent times to curb the franc's appreciation. 1.0600 remains the level to watch as recent dynamics in the spot market saw EUR/CHF unable to sustainably trade below that level.
- Next week's ECB meeting will have potentially high implications for the CHF as a rate cut may further endorse widespread speculation that the SNB will step in with some easing soon (the next policy meeting is on 19 March). This – and the fact that market is expecting an ECB cut – should be able to partly limit the downside in EURCHF this week, which is still likely to remain under pressure on the back of lingering risk aversion.

NOK: Punished when liquidity is a concern

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.4880	Mildly Bullish	10.3770 - 10.6000	10.6000

- NOK has been lagging its cyclical peers during the latest soft dollar environment this week. While Norges Bank cuts are not imminent and the central bank should preside over the favourable interest rate differential vs USD, two factors are weighing on NOK currently: (a) falling oil prices (which make NOK and CAD two laggards in the G10 FX space); (b) NOK's low liquidity (the lowest in the G10 FX space). The latter is currently an issue as investors are becoming more concerned about a liquidity crisis rather than a financial crisis. With the rising EUR/USD, NOK is lifted vs the dollar, but it continues to suffer against EUR. Given the fragile market environment, we look for EUR/NOK to test 10.60 level in coming weeks.
- On the domestic data front, the focus is on the Feb CPI (Tuesday). We are looking for a drop in core CPI from 2.9% YoY to 2.3/2.4%. Even in the context of the collapsing global yield environment, the dovish turn among global central banks and correction in CPI lower, we don't see the NB cuts as necessarily imminent (even if the NB, unlike other central banks, has the firepower to ease policy) as FX is delivering an easing of monetary conditions for the more mechanically minded NB. Still, NOK price action is currently about global risk sentiment, oil price and liquidity concerns, which points to the krone downside.

SEK: An attractive cyclical low yielder in falling markets

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.5940	Mildly Bullish	10.5560 - 10.7000	10.7000

- In falling markets, SEK is the outperformer among the G10 cyclical currencies benefiting from a lack of exposure to commodity prices (vs NOK or AUD) as well as being one of the lowest yielding G10 currencies with a limited room to ease policy (in other words, Riksbank is a mini ECB). This means a relatively modest downside vs the EUR and the outperformance vs USD as SEK, like other European currencies, benefits from the tail wind of the rising EUR/USD.
- Swedish core CPI (Thu) should remain broadly unchanged. While the deteriorating risk sentiment and building downside risks to the global economy are a clear negative for a small open Swedish economy, we don't see the policy easing as imminent (with the next Riksbank meeting only taking place at the end of April – almost two months away). This, within the spectrum of selective easing among G10 central banks, is a marginal positive for SEK and makes the currency an outperformer among cyclical peers in the current challenging market environment.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Disclaimer