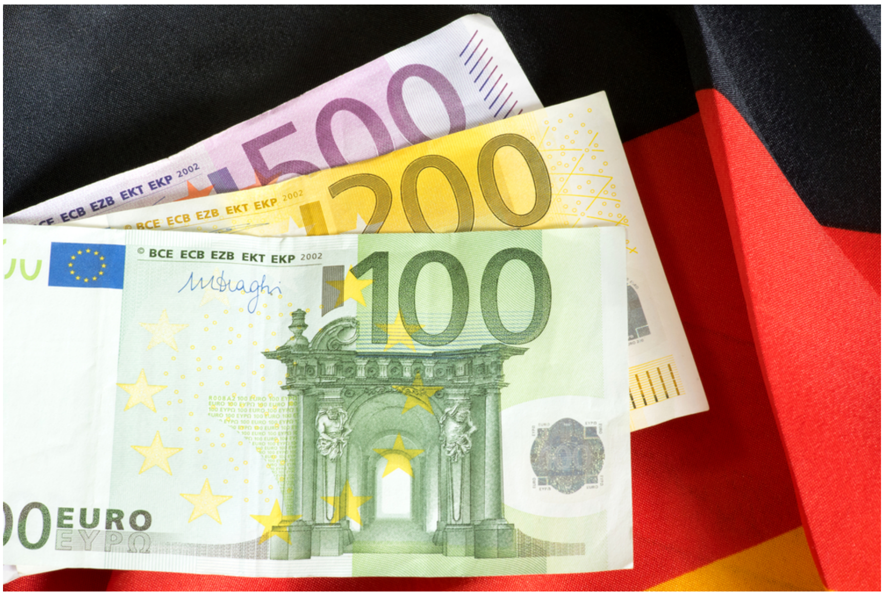
G10 FX Week Ahead: Back from the brink

A deal on migration, better German data and now some contained US wage data has allowed EUR/USD to pull back from the brink at 1.15. Yet firm USD overnight rates and June US CPI pushing close to 3% next week may put a lid on the recovery. More interesting stories in the G10 FX space next week are likely to be local political (GBP) and central bank (CAD) event risks



EUR: Back from the brink?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1750	Neutral	1.1630 - 1.1820	1.1700

- An easing in some of the European political tension and some recovery in German data has allowed EUR/USD to come back from the brink at 1.15. However, a quiet data calendar is not necessarily USD bearish (as used to be the case) given firm overnight USD rates near 2%. And the US June CPI reading (Thursday), which could rise to a new cycle high of 2.9% YoY, will serve as a reminder that the Fed will keep tightening this year. In the eurozone, the focus will be on the German July ZEW investor confidence survey on Tuesday, which is probably at risk of falling given trade tension.
- It's hard to know where the trade story will go this week, although further US retaliation against China looks likely. Trump could well build out the threat of a new 10% tariff on a further US$200 billion worth of Chinese imports. The investment environment's best hope is that President Trump is pre-occupied with his Supreme Court nomination this week, setting the trade agenda to one side. Further consolidation in USD/CNY (after the PBOC appeared to intervene to sell the dollar above 6.70) could also help the more consolidative tone in EUR/USD.

JPY: The yen's identity crisis

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.50	Neutral	109.80 - 111.10	110.00

- USD/JPY continues to trade in narrow ranges, with the yen caught between its role as a safe haven currency versus its entanglement in the broad, trade-driven sell-off in Asian FX. Probably not until global (especially US) equity markets take a decisive turn for the worse will its safe haven role come to the fore. Important technical resistance remains at the 111.00/111.20 area.
- Domestic Japanese data has had virtually no impact on the yen over recent months/quarters. Activity data actually hasn't been that bad and the coming week should confirm some positive trends in wages, business confidence and Industrial Production. In all, we're flat-lining our USD/JPY forecasts around 110 for the rest of the year until it becomes clear how far Trump is prepared to push protectionism.

GBP: Brexit Chequer-mate... focus on what the EU has to say on May's Brexit plan

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3120	Mildly Bullish	1.3050 - 1.3450	1.3500

- At the time of writing, Theresa May is still conducting her crucial Chequers Brexit cabinet meeting - which should ultimately see the UK government unveil its much-awaited Brexit plan. Reports that pro-Brexit cabinet ministers will 'behave' over the coming months is a minor win for the currency. However, for Brexit risks to fully dissipate, the response from EU officials to the UK government's Brexit plan is what truly matters for GBP markets. If Brussels feel they can work with Downing Street's Brexit vision, then we could see a sizable relief rally in the pound – as FX investors turn their attention towards the prospects of an August Bank of England rate hike. Another fudge from the PM could help set GBP/USD on a path towards 1.36 this summer - and 1.40-1.45 by year-end.
- What matters for financial markets is the type of Brexit delivered - not necessarily who delivers it from the UK side of things. In theory, GBP would be able to handle resignations from pro-Brexit ministers - as long as this doesn't result in any question marks over the PM's leadership. GBP's worst outcome is if not only Theresa May's leadership is challenged - and a result we get rising tail risks of a UK general election this year - but if Brussels finds the UK government's Brexit plan as 'unworkable'. The latter would see heightened risks of a Brexit 'no deal' - and prolonged economic uncertainty - which is GBP's kryptonite. In this worst-case scenario, we see GBP/USD sliding down to 1.25-1.27 - and EUR/GBP heading north towards 0.92-0.94.

AUD: Temporary reprieve... but stuck in a lower range

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7410	Neutral	0.7300 - 0.7560	0.7200

- Governor Philip Lowe's latest policy statement was 'low on excitement' according to ING's Rob Carnell - although the Australian dollar did manage to bounce off its recent lows after the release. However, this week's price action was predominantly driven by events elsewhere - namely sentiment over a weak Chinese yuan and the broader sell-off in Asian risk assets. The PBoC's timely verbal interjection helped to stabilise the global risk environment; in the absence of any deviation from the PBoC's stable FX policy, we'd expect this source of market risk to be negligible for the AUD going forward.
- But AUD price action will still continue to be driven by external events and given the unpredictability of US trade policy that we've been accustomed to, one can never rule out an anti-trade tweet that could dampen global risk sentiment. The domestic calendar has little in the way of meaningful data catalysts - business confidence (Tuesday), consumer confidence (Wednesday) and July consumer inflation expectations (Thursday) are second-tier releases to note. With the Aussie indirectly caught in the crossfires of a US-China trade war, look for AUD/USD to remain stuck in the 0.73-0.75 range for now.

NZD: Positive terms of trade story has sharply reversed course

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6820	Neutral	0.6700 - 0.6950	0.6900

- Having had a torrid few weeks of late, the New Zealand dollar endured a short squeeze this week as global risk sentiment turned the corner (PBoC verbal intervention) and the USD rally ran out of steam. However, it's worth noting that the fundamental backdrop for the NZD has weakened of late - with NZ dairy export prices falling back to their January 2018 levels. As such, the kiwi's support from a higher terms-of-trade channel has deteriorated quite noticeably in recent months - and partly explains the softer FX price action.
- On the local data front, we have a few second-tier releases to note - retail spending (Monday), house sales (Monday) and manufacturing PMI (Thursday). In the current global environment, the RBNZ is pretty much a redundant factor and we note that the NZD OIS curve is not pricing in any tightening until 3Q19. NZD/USD's corrective rally could run higher in a quiet week - though we still look for the pair to trade below 0.70 for the foreseeable future.

CAD: Surely Poloz won't surprise markets with a hold?

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3130	Mildly Bearish	1.2950 - 1.3220	1.3000

- Markets are all but pricing in a 25 basis point rate hike at next week's Bank of Canada meeting (Wednesday). But as is the case with most central banks, calls on policy tightening will likely go down to the wire given the volatile nature of US trade policy – and by extension global markets. Odds of a BoC rate hike disappointment next week are therefore in theory non-negligible – but surely we would have seen some verbal interjections from BoC officials by now should they have deemed current market expectations to be too optimistic.
- The latest batch of Canadian data was on the surface good enough to seal the deal for a rate hike next week; while annual wage growth dipped to 3.5% YoY, domestic jobs growth printed pretty solid at +31.8k (albeit a large chunk of this was due to part-time workers). Should the BoC follow through with a rate hike, then we'd look for USD/CAD to continue its corrective decline towards 1.30. On the flipside, a dovish disappointment and no rate hike could see a sharp knee-jerk move lower in the loonie - with USD/CAD moving up to 1.33-1.34 as the Canadian rate curve flattens. We see the former scenario - and USD/CAD at 1.30 next week - as our base case.

CHF: Political premium eases from CHF

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1630	Mildly Bullish	1.1570 - 1.1660	1.1700

A relatively successful EU summit has seen some of the political risk premium ease out of the Swiss franc, allowing EUR/CHF to edge back above the 1.16 area. A more aggressive rise, e.g. through the 1.1660 area probably requires substantially more confidence in the euro – which may not be coming this week given the quiet eurozone data calendar and escalating trade wars.

As always, the market will be looking at Monday's weekly CHF sight deposit data for any signs of intervention by the Swiss National Bank (FX reserves rose CHF8 billion in June). We should also see a low unemployment rate and probably another rise in PPI (currently at 3.2% YoY). Yet the SNB has made it clear that a short-term pick-up in inflation is to be expected and that will continue to lag the ECB tightening cycle.

SEK: Misreading the Riksbank

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2800	Mildly Bullish	10.2200 - 10.3600	10.4000

The Riksbank surprised on Tuesday with an optimistic assessment of the economy and thereby coming across rather hawkish relative to prior meetings. There seems to be a shared patience amongst developed market countries as we wait for the trade war fog to settle and eventually spell out the future of international trade. At this stage we do not, however, expect the Riksbank to hike until July 2019, versus current pricing of 4Q18. The market's over-hawkish interpretation of the Riksbank meeting could be exposed with the release of Riksbank minutes this Thursday.

Over the coming week, Swedish June CPI on Thursday will most likely be the main driver for EUR/Swedish krona. We estimate CPI heading up to 2.3%, which is on consensus. However, we should not forget that auto tariffs could be lurking around the corner. Correspondingly, Volvo is rolling out a new plant in South Carolina as a natural hedge against US tariff uncertainty which could work in their favour if US margins are suddenly pinched. In all, we don't want to chase the recent strengthening of the SEK.

NOK: Upside risks to CPI

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.4400	Neutral	9.4000 - 9.5000	9.3000

Norwegian CPI is scheduled for Tuesday and we're a little above consensus with a forecast of 2.5% YoY for headline (1.1% core) – largely driven by energy. An outcome in line with our reading should support the case for a September Norges Bank rate hike, which only looks 50% priced in.

The oil price is still trying to make up its mind, caught between OPEC+ supply increases and new sanctions on Iranian supply (+ Canada & Libyan outages). On balance we're still constructive on the Norwegian krone.

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