

G10 FX Week Ahead: Yield not to temptation

Some investors might start to get dragged out of equities and into bonds by temptation of higher yields in the coming weeks if, as we expect, the Treasury sell-off has further to run. Any hint at inflation targeting and YCC in the FOMC minutes next week should be USD negative, however, and some promising EZ PMIs could let EUR/USD re-test the highs




USD: Trading off the US yield vs. Fed dynamic

	Spot	Week ahead bias	Range next week	1 month target
DXY	93.1000	Mildly Bearish 	92.0000 - 93.7500	91.0000

- Heading into next week we see the dollar driven by two key factors: i) our rates team feel that supply pressures (20-year US Treasury auction on Wednesday) can see US yields back up another 20bp – e.g. US10-year to 0.90% – over coming weeks. That could tempt some money out of equity markets. ii) What the Fed does at its September meeting will be key. Minutes of the July FOMC meeting are released on Wednesday and any suggestion of impending Average Inflation Targeting (AIT) or Yield Curve Control (YCC) would be a dollar negative. On balance we would prefer to back the latter story next week, meaning that the DXY could make a new low.
- In addition, the market will be looking at the mood music following the US-China Phase One trade deal review, which takes place this Saturday. Indications are that neither side want this deal to unravel. Also on the US calendar is housing data. This should be strong given low mortgage rates and strong mortgage applications. Housing data for the time being should support the V-shaped scenario priced into cyclical assets.

EUR: Promising PMI's?

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1830	Mildly Bullish 	1.1720 - 1.1915	1.2000

- After a week of consolidation, we think EUR/USD could go back to test the highs. This relies on the FOMC minutes presenting enough dovish excitement to keep US real yields under pressure. From the EUR side of the equation, this week's highlights will be Friday's release of the flash Eurozone PMIs. These have rebounded impressively and could well enjoy a further uptick in the August release. September may be a less encouraging picture as second wave cases increase on the continent and renewed restrictions are considered.
- A slightly more difficult bond market environment may warn of widening in the BTP-Bund spread (a Euro negative). Yet our debt team feel that the carry trade story is well insulated in Europe (EUR excess liquidity at the ECB stands close to EUR3tr) suggesting that any BTP sell-off is short-lived.

JPY: On the receiving end of the Treasury sell-off

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	106.54	Neutral	105.80 - 107.50	104.00

- Steeper yield curves in a reflationary environment would typically see the JPY underperform on the crosses and USD/JPY trade higher. The Treasury sell-off could briefly push USD/JPY over 107 in the week ahead. Incidentally, Japanese buying of foreign bonds does seem to be running at a high rate of JPY1tr per week – let's see whether that lasts.
- Local data sees Japanese 2Q20 GDP. Our team see -5% QoQ, slightly better than the market, though we doubt the data will have much market impact. We'll also see Japanese July export data. Japan's exports seemed to suffer more than Korea's (e.g. June data in Japan at -26% YoY vs. -11% in Korea) and a recovery in July would provide some encouraging signals about the external environment.

GBP: Trade talks on a road to nowhere

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3110	Neutral	1.3020 - 1.3200	1.3100

- GBP has been trading tight ranges in spite of recent insights from both the BoE and the 2Q GDP data. UK data in the week ahead will see July CPI, August PMIs and July retail sales data. The activity data should support the recovery narrative, even though the outlook may start to deteriorate into September as higher joblessness starts to come through.
- Also in focus will be the next round of UK:EU trade talks. Despite optimistic tweets in advance of the meeting, we see little progress being made on key sticking points such as state aid. We do not see GBP getting a lift from this.

AUD: Above 0.72, but more upside will be harder

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7150	Mildly Bullish 	0.7100 - 0.7250	0.7100

- The Aussie dollar has held marginally below the 0.7200 mark as the antipodeans lagged other procyclicals this week and despite a quite encouraging set of jobs data in Australia. Attention remains on the virus/lockdown developments in the country: Victoria appears to be showing a flattening in the contagion curve and this is starting to fuel some hopes of easing restrictions.
- Meanwhile, RBA Governor Lowe highlighted how the big second virus wave in Victoria has likely erased the recovery effort in other parts of the country. He also discussed negative rates in a Parliamentary testimony, but said those are extremely unlikely. Investors will look into the RBA August policy meeting minutes next week to track any signs of shifts in the Bank's stance, but we doubt the release will bring much surprise. AUD/USD can aim at trading above 0.7200 next week, largely on USD weakness, but may find further upside more difficult to achieve if there are more signs of slower-than-expected Chinese recovery.

NZD: The RBNZ effect should not last

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6540	Mildly Bullish 	0.6510 - 0.6610	0.6700

- The Kiwi dollar is the key laggard in G10 this week after the dovish message sent by the Reserve Bank of New Zealand. We discuss the implications for NZD in ["Can the RBNZ really curb the Kiwi \\$?"](#). We continue to think that the RBNZ will have to deliver on its threat to cut rates to negative to substantially dampen the NZD.
- Next week the NZ calendar is quite uninspiring, and we expect NZD to broadly move in line with AUD on the back of global and Chinese-related reflation sentiment. We do not see NZD still underperforming AUD on the back of the RBNZ dovishness and – if anything – there is more room for some NZD rebound after a grim week.

CAD: Marching on (if oil resilience lingers)

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3270	Mildly Bearish 	1.3150 - 1.3300	1.3300

- CAD is a leader in the risk rally in G10 and likely benefiting from some unwinding of its excessive short positions. The key condition for this dynamic to persist is the continuation of resilience in the oil market which is providing substantial support to the loonie. The lower exposure to China and trade tensions continues to suggest CAD may be a favourable option than antipodeans within the \$-bloc space if risk sentiment remains bid.
- Next week's data should play second fiddle to external drivers. Inflation is set to have slowed to 0.5% in July according to consensus, but this hardly suggests immediate additional action by the Bank of Canada. Retail sales should be of more interest, and provide the measure of the economic rebound in June. Still, the numbers will be a bit outdated and should have a somewhat limited impact on CAD.

CHF: EUR/CHF locked in tight ranges

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0750	Neutral	1.0720 - 1.0800	1.0700

- EUR/CHF remains trapped in tight summer ranges and we see no reason for a break-out – unless a disorderly sell-off in Treasuries starts to hit US equities. We could also see CHF outperformance were USD/CHF to break under the 0.90 level – an event last seen in early 2015 when the SNB pulled the plug on the 1.20 floor.
- Notably EUR/CHF has not made much upside progress on the EU Recovery Fund news – unlike Italian BTPs – which may owe to ECB balance sheet expansion.

SEK: Market affinity for the krona to linger

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.2930	Mildly Bearish 	10.2250 - 10.3200	10.2000

- The krona continues to show a good performance amid diverging dynamics in activity currencies. It seems hard to see investors' affinity with the SEK being reverted anytime soon, and the currency should continue to prove it's laying on a fairly solid floor.
- Next week data will hardly offer any domestic catalyst to SEK. Jobs data will be watched, with the unemployment rate possibly having flattened up in July from June's levels.

NOK: No surprises by the Norges Bank

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.5360	Mildly Bearish ▼	10.3950 - 10.6000	10.5000

- NOK continues to show higher upside than its G10 peers and is benefitting from further good signs coming from the oil market. Next week's Norges Bank policy meeting may do very little to either curb or add steam to NOK's rally.
- In what will be an inbetween meeting (which means no new forecasts and a probably short statement), the NB should simply reiterate the same monetary policy stance displayed in the latest announcement. A cautiously more optimistic tone than other G10 central banks should not come as a big surprise. We expect the rate announcement to be a non-event for NOK.

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