The dollar's inflection point

As investors lose faith over additional Fed tightening prospects, the onus falls on US inflation numbers to vindicate or refute bearish USD sentiment

Source: iStock

Majors: Can US inflation data turnaround diminishing Fed rate odds?

We may require a mighty turnaround in US data over the coming months to convince the FOMC to raise rates in December; this is becoming increasingly unlikely and judging by more muted Fed comments, it seems that US policymakers are also losing faith. Add to this ongoing US political uncertainty – where the temporary debt ceiling extension has merely kicked the can down the road into early 2018 – and we fear that markets could still shift to the idea that any "pause" in the Fed's tightening cycle will be fairly lengthy (if not permanent). Another set of disappointing US data releases, while not our base case, would deliver final nail in the coffin for a Dec Fed rate hike.

EUR: Testing the ECB's pain threshold

- The forces required to make the US dollar great again are quickly falling by the wayside. Of late, it has been a Fed story – with the negative economic effects of Hurricane Harvey (and now Irma), North Korea tensions and lacklustre US inflation dynamics seeing odds of another Fed hike this year tumble to 28%. We may need to see an all-mighty turnaround in US data to convince the Fed to raise rates in December; this makes the August CPI data (Thu) this week very important. Our economists expect headline CPI to pick-up to 1.9% YoY, while base effects could weigh on core inflation (1.6% YoY vs. 1.7% prior). A negative CPI surprise, however, would deliver the final nail in the coffin for a Dec rate hike. US retail sales (Fri) should point to stronger consumer activity, which could support USD sentiment towards the end of the week.
- The EZ data calendar is fairly quiet but the focus will be on ECB talk and whether officials attempt to 'talk down' the EUR. Given the way the central bank has conditioned their inflation forecasts, we think that any sharp appreciation in EUR/$ beyond 1.20 – and heading closer towards 1.25 – would be nearing the ECB's pain threshold (assuming ceteris paribus of course). More noise over the ECB's disinflationary concerns in the near-term may keep EUR/$ upside contained to the 1.2160/70 area – which is the 50% retrace of the 2014-17 move lower.

		Week ahead bias	Range next week	1 month target
EUR/USD	Spot ref: 1.1910	Mildly Bearish	1.1920-1.2170	1.20

Source: Source: ING

JPY: Balancing geopolitical tail risks and US data

- Signs of a cyclically declining dollar - driven by a multitude of factors including diminished Fed tightening cycle expectations and heightened US/global political risks - is keeping USD/JPY firmly below the 110 level. While North Korea's Foundation Day did not see another highly-publicised ICBM launch, we expect investors to remain cautious over the coming weeks. In the near-term, a decent set of US data releases could inject some upside bias to pair throughout the week.
- On the Japanese data side, there's not a lot to note but watch out for BoJ bond buying in the week - which could be used to temper any JPY upside.

		Week ahead bias	Range next week	1 month target
USD/JPY	Spot ref: 109.60	Mildly Bullish	107.30-109.40	109

Source: Source: ING

GBP: Upside risks to UK rates from Sep BoE meeting

- The combination of more robust UK inflationary signals and a slight hawkish tilt at the September BoE meeting (Thu) - at least relative to what markets are pricing in - could provide a turning point in the GBP sentiment this week. With near-term political risks priced in - and any fallout from Parliament's EU Repeal Bill vote likely to be short-lived - we look for a 2.8% headline CPI print (Tue) and higher wage inflation in the jobs report (Wed) to nudge GBP higher.
- We look for a 7-2 MPC vote split at the BoE event, though we do think the risks are skewed more towards there being a third dissenter (as opposed to a retreating dissenter). While the statement may refer to renewed political risks and retain much of the same cautious rhetoric as last month, we expect to see more direct references to GBP weakness - and what this could mean for the growth-inflation policy trade-off. Equally, some MPC members may cite this as a reason for earlier hikes than previously anticipated in the meeting minutes. Overall, we see potential upside risks to short-term UK rates and GBP from the BoE meeting.

		Week ahead bias	Range next week	1 month target
GBP/USD	Spot ref: 1.2950	Neutral	1.3050-1.3300	1.30

Source: Source: ING

Dollar bloc: Cautious carry

While a benign global interest rate environment is being offset by a nervous geopolitical backdrop, the former seems to be winning out for high-yielding dollar bloc currencies

AUD: External conditions hold the key amid neutral RBA

- The RBA meeting was a non-event as expected, with the central bank retaining the same cautious commentary over a strong AUD. Domestic data focus this week will be on the August jobs report (Thu); we note Governor Lowe's speech last week had a blend of caution mixed with optimism, and the latter stems from diminishing labour market slack leading to higher wage inflation. After a negative full-time employment release in July, we'll be looking to see if this bounced back last month.
- Elsewhere, we get the RBA's Debelle speaking (Thu). though we expect no deviation from the current dovish-neutral policy bias. External conditions continue to drive AUD/USD; US data will matter here, though expect any support to be more of a short-term reprieve for the USD, rather than the start of a broad-based recovery.

		Week ahead bias	Range next week	1 month target
AUD/USD	Spot ref: 0.7960	Mildly Bearish	0.7900-0.8180	0.78

Source: Source: ING

NZD: Light week for data means narrower election focus

- Aside from a narrower focus on the 21 Sep elections, the domestic calendar is fairly sparse - with only second-tier data releases such as retail spending (Mon), consumer confidence and manufacturing PMI (both Thu) to note. We'll also get REINZ house price data (Thu) and here we'll be looking for confirmation of falling house prices; as noted previously, this story removes any tail risk of RBNZ rate hike to address financial stability issues.
- Geopolitical tensions seem to be having a limited effect on high-beta currencies, with the dollar mainly suffering amid a confluence of negative domestic and external factors. We continue to think an escalation in North Korea tensions - while not our base case - would eventually weigh on traditionally riskier currencies like NZD.

		Week ahead bias	Range next week	1 month target
NZD/USD	Spot ref: 0.7180	Mildly Bearish	0.7150-0.7350	0.71

Source: Source: ING

CAD: Time for a breather

- After the BoC’s second consecutive rate hike this week, our economists suspect that there will be a pause in monetary policy. We tend to agree; both the broader geopolitical uncertainties – with Canada’s main trading partner, the US, front and centre – and notable concerns over the ability of highly indebted households to absorb higher interest rates, require a ‘wait-and-see’ BoC policy approach in the near-term.
- Moreover, we've yet to see the economic fallout from a strong CAD; the July MPR forecasts were based on $/CAD at 1.31-1.32 and the move down to the low 1.20s should be seen as a drag on the BoC's policy reaction function. These second-round disinflationary effects could well serve as a backstop to further BoC tightening. We only see downside risks to the market pricing of 70bp of BoC hikes over a 1Y horizon. Only house price data to note in the week ahead.

EUR crosses: SNB to distance itself from the ECB

General elections will keep NOK market interested today, while we expect the SNB meeting this week to reinforce the theme of monetary policy divergence in EUR/CHF

CHF: SNB-ECB divergence to reinforce EUR/CHF upside

- The highlight this week will be Thursday's SNB meeting. Expect the SNB to fan the flames of divergence between itself and the ECB, allowing rate spreads to widen and EUR/CHF to strengthen. The SNB still thinks the CHF is overvalued, whether it drops the adverb 'significantly' could be of interest.
- The bottom line, however, is that ECB QE broke EUR/CHF and the SNB now expect ECB tapering to fix it. We agree with their position and see scope for a big rally over the coming quarters. At Thursday's meeting expect the SNB to focus on subdued growth, low inflation and weak trade. Macro theory would suggest a weaker CHF is required.

		Week ahead bias	Range next week	1 month target
EUR/CHF	Spot ref: 1.1400	Mildly Bullish	1.1360-1.1520	1.16

Source: Source: ING

SEK: New target, old policy

- The Riksbank switch to a CPIF target was greeted with little fanfare, as was their unchanged policy - which continues to see the first hike in 3Q18. Technically, EUR/SEK looks as if it could nudge a little higher this week and will be on the look-out for SEK negative news.
- That news could potentially come Tuesday with the release of August inflation data. The July release of CPIF at 2.4% YoY had lifted the SEK. Consensus sees 2.2% and were there any downside surprises, SEK would sell-off. This week we see 9.51/52 as a key area for EUR/SEK.

		Week ahead bias	Range next week	1 month target
EUR/SEK	Spot ref: 9.4750	Mildly Bullish	9.5100-9.5800	1.16

Source: Source: ING

NOK: Surprise win by Labor could hit the krone

- All eyes are on Monday's general elections. Recent polls have pointed to a continuation of the centre-right government, although the election should be close; any surprise win by Labor could hit the NOK.
- The NOK hasn't really been benefiting from the recent run-up in oil prices. We have a slight bias for EUR/NOK to edge up to the 9.37/38 area, but it is not a call held with conviction. Range trading is the preferred option and our commodities team still has a preference for lower crude later this year.

		Week ahead bias	Range next week	1 month target
EUR/NOK	Spot ref: 9.2830	Mildly Bullish	9.3000-9.3700	9.20

Source: Source: ING

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