# G10 FX Week Ahead | Trump’s infinity trade war

There doesn't seem to be any let up in the myriad of risks facing global markets in the week ahead with US-China trade tensions, Italian politics and general sentiment towards EM assets all in focus. It's highly unlikely the US finds a quick 'win' in their various trade negotiations (China or NAFTA) meaning uncertainties are likely to linger for a while


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## EUR: More of the same….

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/USD | 1.1760 | Mildly Bearish ↘ | 1.1660 - 1.1900 | 1.1900 |

- We look for more of the same in terms of the EUR/USD outlook next week, with the cross staying under a modest downside pressure. In US, the focus remains on the ongoing trade negotiations with China. There has been some encouraging signs (Chinese offer to cut its trade deficit with the US by USD200bn) but negotiations remain ongoing, in turn keeping the threat of trade tension alive. Also note the expiration of the deadline (on Tuesday) for the US companies to voice their concerns about the potential tariffs.
- In Europe, the key main focus remains on Italian politics where the collation government in making is to meet President Mattarella on Monday (there could be a backlash from the President against some of the anti-immigration policies). While we expect the headline noise to continue flowing, the rejection of the speculations about the EUR referendum and the debt write-down suggest the negative spill over into the EUR spot should be limited. On the data front, we look for largely unchanged EZ May PMIs (Wed) and German May IFO (Fri). Overall, there does not seem any major impetus for EUR to rally next week while supported UST yields (the FOMC Minutes on Wed should reiterate the Fed's gradualist approach to tightening) and the uncertainty about global trade do not suggests a reversal of EM FX fortunes against USD

## JPY: EM car crash to help the yen?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/JPY | 110.85 | Neutral | 110.00 - 111.50 | 109.00 |

- USD/JPY has so far ignored some of the sharp sell-offs in EM and instead taken its cue from US yields. However, the EM sell-off is starting to broaden - even the popular South Africa re-rating story has come under heavy pressure - and warns that USD/JPY should not be blindly followed higher. If EM contagion spreads broadly, prompting aggressive rate hikes in EM, a slower EM growth profile will hardly be positive for global growth or US yields.
- We think USD/JPY could briefly push onto the 111.50 area in the week ahead (very outside risk to 112.50) but feel that recent gains are very susceptible to a sharp reversal. The coming week could prove very noisy on the trade front - eg, US hearings on Chinese tariffs, threats of retaliation by China - let alone the prospect of NAFTA negotiations being abandoned ahead of Mexican elections in early July. So it seems far too early to be counting on a return of a benign risk environment.

## GBP: Royal wedding fever fails to spillover into nervous pound

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| GBP/USD | 1.3470 | Mildly Bullish | 1.3400 - 1.3700 | 1.3800 |

- It's a big week for GBP in terms of UK data. We would argue that markets have lost faith and conviction over BoE policy tightening - in part due to sheer confusion over the central bank's policy reaction function in a post-Brexit world. But we now place a strong emphasis on UK data to guide BoE policy expectations - and it's pretty clear to us what would validate our call for an August rate hike: (1) signs of resilient underlying inflationary pressures; (2) a rebound in economic activity after the 1Q soft patch and (3) no complete breakdown in Brexit negotiations (thus corroborating the Bank's smooth Brexit adjustment assumption).
- We don't think the UK government's constant customs union flip-flopping will have much of a sustained impact on GBP price action - and more broadly on Brexit, we think the risk of a breakdown in UK-EU talks is trivial at this stage. So the emphasis for GBP markets in the week ahead will be on the April CPI (Wed) and retail sales (Thu) data - as well as the second estimate for 1Q UK GDP (Fri). The perfect week for GBP bulls would be signs of sustained underlying inflationary pressures (core CPI at 2.2% YoY), a bounce back in ex-auto consumer spending (ING: +0.2% MoM; consensus: +0.5%) and a slight upward revision to 1Q UK GDP (prior +0.1% unexpected to change). Note we also have BoE officials - including Governor Carney - testifying to UK lawmakers (Tue); we do not expect any explicit policy signals, with officials happy to let the data do the "talking".

## AUD: Taking its cue from the broader risk environment

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| AUD/USD | 0.7510 | Neutral | 0.7400 - 0.7600 | 0.7600 |

- The latest Australian jobs data was a bit of a mixed bag; while full-time employment picked up by +32.7k in April, the downward revision to last month's figure and the uptick in the unemployment rate to 5.6% are slight disappointments. We'll get an update on the RBA's latest thoughts in speeches by Governor Lowe (Wed) and Assistant Governor Bullock (Thu); one would imagine officials retaining a fairly neutral and cautious stance in light of the current domestic economic and geopolitical backdrop.
- The standout data release in the week ahead is the 1Q construction work done report (Wed) - consensus is looking for a +1.3% QoQ bounce back after the largest quarterly decline on record in 4Q17 (-19.4%). Broadly, AUD/USD will continue to take its cue from global risk sentiment and here we look for some consolidation in the absence of any further escalation in geopolitical and trade risks.

## NZD: Cleaner positioning raises bar for further downside

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| NZD/USD | 0.6900 | Neutral | 0.6870 - 0.7000 | 0.7200 |

- Just when one would've thought that it couldn't get any worse for the kiwi, the lacklustre 1Q PPI release and negative global risk environment has seen NZD/USD drop to its lowest levels since Dec 2017 (when negative sentiment around NZ politics was at its peak). Certainly, the pair is sensitive to higher US yields and we suspect this will remain the persistent theme given the greater short-run uncertainty over global growth.
- However, with NZD positioning slightly cleaner, we would only expect a further material decline now if (a) we see evidence that higher US rates pose downside risks to a highly leveraged NZ economy (in particular the local housing market) or (b) we see another idiosyncratic move higher in US rates (which seems unlikely now with markets all but pricing in the end of the Fed tightening cycle). The likelihood is that NZD/USD consolidates around the 0.70 handle until we get clarity on the broader global backdrop. Domestically, 1Q retail sales (Mon) and trade balance data (Wed) will be of interest.

## CAD: Gearing up for a period of outperformance this summer

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/CAD | 1.2880 | Neutral | 1.2720 - 1.2950 | 1.2500 |

- After US Trade Representative Lighthizer's comment that we're "nowhere near close to a deal", it's becoming increasingly likely that a NAFTA resolution will not be on the table before the 30 May BoC policy meeting - meaning that the central bank will have to see sufficient evidence in the macro data to convince them to hike rates at the big July meeting. The latest CPI and retail sales data had mixed implications for policy. Slightly softer inflation won't be too much of a concern for the BoC given that their recent focus has been on the activity side of the economy. Here the core retail sales decline (-0.2% MoM) is pretty uninspiring - despite the +0.6% pick-up in headline retail sales due to a large one-off uptick in new car sales. Overall, this suggests a May rate hike (40% priced in) looks highly unlikely - though any re-pricing here should have a minimal impact on CAD.
- While we estimate USD/CAD to be fair around the 1.28 level, we note that there are a myriad of conflicting factors driving the pair. Higher oil prices and signs that the US-Canada 2-year rate differential may be starting to narrow (after potentially peaking) offer support to a higher CAD, while the negative global risk environment and relative underperformance of Canadian stocks present headwinds for the currency. Should the latter fade - and CAD's initial fallout to a May BoC rate hike being taken off the table stabilise - then we could see a period of CAD outperformance this summer ahead of the July BoC meeting (where we expect a 25bp BoC hike).

## CHF: BTP-Bund spreads could send EUR/CHF even lower

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/CHF | 1.1750 | Mildly Bearish ↘ | 1.1670 - 1.1800 | 1.1800 |

- Italian political has come home to roost in an aggressive way, taking a huge toll on EUR/CHF. The BTP-Bund spread has widened a huge 30bp on the week to 160bp. Our debt strategy team feel that this could widen a little further to the 175bp area - suggesting EUR/CHF could drop into the 1.1650 area, but that should be enough for the time being they think - perhaps with President Mattarella curbing the more aggressive impulses of the potential new populist government.
- Locally, Thursday sees Swiss 1Q18 Industrial Output. Given the headwinds experienced by Germany in 1Q18, presumably, the YoY figure will slow dramatically from the 8.7% seen in 4Q17. Also, we're getting closer to the 10 June Vollgeld referendum. Any opinion polls showing any progress for the 'Yes' camp could prove a CHF negative.

## SEK: The one-off rebound stalling

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/SEK | 10.2920 | Neutral | 10.2450 - 10.4000 | 10.5000 |

- The SEK gains against EUR stalled, exerting signs of a short squeeze from oversold levels rather than a fundamentally driven rebound. We continue to see SEK as vulnerable to the risk of global trade tensions.
- Data wise, the calendar is very quiet. The Swedish April unemployment rate may tick modestly lower. On the monetary policy side, there the Riksbank's biannual Financial Stability Report and the speeches at the Riksbank's 350-year anniversary conference. However, don't expect SEK to get much boost from potential hawkish hints as long as these hints are made by the well know hawks who remain in minority. The lack of meaningful SEK gains after the hawkish comments from Deputy Governor Skingsley provide a case in point.

## NOK: Cushioned by the oil price

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/NOK | 9.5660 | Neutral | 9.5000 - 9.6580 | 9.4500 |

- The next week's data provide very limited domestic NOK drivers. Of note is the March unemployment rate (Fri) but this should have a non-negligible impact on NOK. The rising oil price should remain supportive of NOK and provide a cushion the currency (and further increase the odds of the September NB rate hike).
- We continue to see NOK/SEK gains over the course of this year as hawkish NB (vs dovish Riksbank) should underpin the diverging prospects for both currencies.

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