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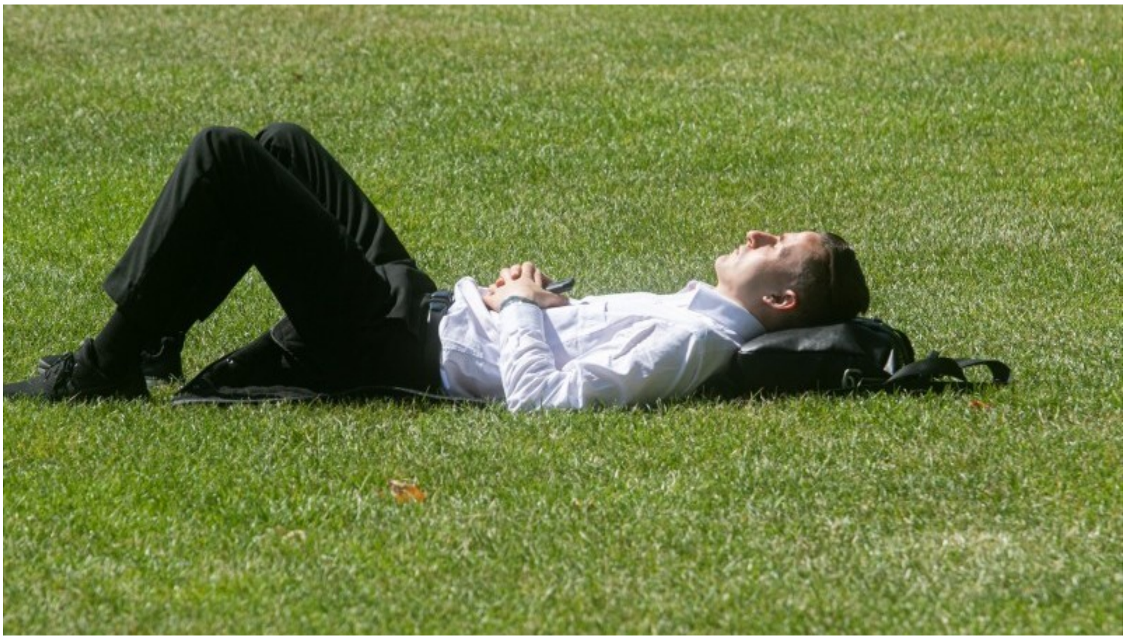
Article

# G10 FX Week Ahead: Summer lull going viral

Summer trading ranges are setting in and we see little scope for G10 FX volatility next week, with second waves still failing to deliver a significant hit to sentiment. News on the EU Recovery Fund and UK spending plans (which may give a time-limited push to sterling) will be in focus while the Reserve Bank of Australia may leave little mark on the Aussie dollar



## USD: Questioning the numbers

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| DXY | 97.2800 | Neutral | 96.5000 - 97.8000 | 95.0000 |

- The dollar has gone into consolidation mode, with investors caught between hopes of recovery and fears that the US second wave outbreak will turn into something more deadly. There also remains much uncertainty over the US unemployment situation. Despite the strong June nonfarm payrolls reading, there are still 31.5 million people claiming unemployment benefit and a rise in the next weekly jobless claims number could pour cold water on recent optimism. We also see US Treasury auctions next week and a chance to gauge whether demand is as strong as usual.
- Apart from the weekly jobless claims data, our team expects to see a strong US June ISM services report on Monday and despite Congress being on a two-week recesss, there will be focus on whether the CARES act is extended, i.e. whether the $600 per week in extra unemployment benefits gets extended beyond the end of July. So far, presidential election polling has had little impact on FX markets and we do not expect that to change until late August/early September. In short, it looks like the summer lull is setting in and rangebound $/Majors looks to be the order of the day.

## EUR: EU Recovery Fund compromise?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/USD | 1.1230 | Neutral | 1.1170 - 1.1300 | 1.1300 |

- EUR/USD has held up slightly better than we expected – as have the pro-cyclical currencies – which no doubt is being supported by abundant dollar liquidity and perhaps signs that the Chinese activity rebound is continuing. We're still seeing a negative correlation between the dollar and equities, although as we discussed last week, we wonder whether the US second wave story can start to drive independent dollar weakness.
- For the week ahead, the eurozone sees the July Sentix confidence reading and May retail sales (both expected to rebound further). Also look out for any updates on the EU Recovery Fund. European Commission President Charles Michel is expected to propose a compromise plan – primarily to get the Dutch on board – and the proposal may be reviewed at the Eurogroup meeting of Finance Ministers on Thursday/Friday. Earlier in the week, the European Commission releases updated economic forecasts on Tuesday. Falling option volatility favours a rangebound EUR/USD over the week ahead, but there's still the risk that a rising US death toll on the back of a fresh wave in cases prompts a more severe lockdown and a re-connection between Wall Street and Main Street.

## JPY: GPIF confidence takes a knock

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/JPY | 107.52 | Neutral | 106.80 - 108.00 | 107.00 |

- USD/JPY is back to trading in narrow ranges and one gets the sense that any yen volatility to emerge will do so on the crosses with USD/JPY staying anchored. In a quiet week, we've seen some focus on the Government Pension Investment Fund performance in 1Q20 – a $165 billion loss. That's no surprise given a 50% benchmark weighting to equities. Should we expect a political backlash? Probably not. The GPIF has performed very well over the last 20 years and with JGB yields at zero, the GPIF must find a way to make returns for 'all generations'. Thus we would expected it to maintain its 40% weight to foreign assets – a key channel to re-cycle Japan's current surplus.
- In the week ahead, the Japanese calendar sees the May current account surplus – expected to widen again – and the Eco watchers survey for June. We'll also get the weekly update on Japanese foreign bond buying. In terms of domestic debt, there has been some focus on the recent steepening of the JGB curve – especially in the 30-year area. Any sharper sell-off, may see the Bank of Japan further lengthen the maturity of its JGB buying operations.

## GBP: New spending plans to have only one-off impact on sterling

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| GBP/USD | 1.2458 | Mildly Bullish | 1.2250 - 1.2690 | 1.2300 |

- The UK-EU trade negotiations have been showing a little progress and it is fairly unlikely there will be a change in the stance next week. As the UK-EU trade outlook is the main GBP driver, the uncertainty associated with it suggests limited GBP upside over the summer months, with GBP remaining the G10 FX underperformer.
- Rather, the focus next week turns to the summer economic update from Chancellor Rishi Sunak (Wednesday). Tax cuts are probably unlikely but we should see targeted measures to cushion the rise in unemployment (such as wage subsidies for firms taking new staff or preserving jobs). If there is meaningful new spending, this may provide a boost to GBP on the day, but its effect should be a one-off and unlikely to last as the overriding GBP determinant remains the outlook for the UK-EU trade deal – which, as per above, should remain under a veil of uncertainty.

## AUD: RBA a non-event if no mention of AUD strength

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| AUD/USD | 0.6940 | Neutral | 0.6850 - 0.7000 | 0.6700 |

- The Reserve Bank of Australia meeting next week is unlikely to yield any material surprise or changes to the policy stance, and should therefore have a limited impact on the Aussie dollar. As highlighted in our RBA preview: Currency comments to drive reaction, there is a chance that the RBA will want to change its relaxed stance on the relatively strong AUD: a simple acknowledgement (like the Reserve Bank of New Zealand did recently) that it is posing a hindrance to the economic recovery might be enough to trigger some AUD losses.
- However, evidence from the past few meetings suggests the reaction may not be very significant in size, and global risk sentiment should still be the key determinant of AUD moves next week. Barring major swings in sentiment, we may still see AUD/USD trade within the 0.6850/0.700 range next week.

## NZD: Tougher than the RBNZ threat

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| NZD/USD | 0.6526 | Neutral | 0.6450 - 0.6600 | 0.6300 |

- The New Zealand dollar has once again proven to the RBNZ that the threat of negative rates is not enough to keep the downside capped, as a good week for risk-sensitive currencies has seen the NZD outpacing even the AUD.
- Positioning data shows that the NZD has virtually lost all its “positioning advantage” as it migrated from oversold territory into a neutral one. This endorses our view that the NZD may be facing a correction in the coming weeks before trending higher in the rest of the second half. Next week should not offer clear catalysts to NZD, which should trade rangebound if market sentiment continues to stabilise.

## CAD: Jobs in focus

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| USD/CAD | 1.3570 | Neutral | 1.3480 - 1.3680 | 1.3500 |

- The Canadian jobs report last month followed the US in delivering a surprising jump. Inevitably, this is keeping expectations for the June report (due next week) quite high after this Thursday's US numbers. A rise in employment above 500k may provide support to the Canadian dollar, although the impact may be relatively short-lived with questions likely to be raised about the reliability of the report and the true unemployment numbers, as seen in the US.
- Also in the Canadian calendar, the Bank of Canada's Business Outlook for 2Q will be worth monitoring. All in all, we expect USD/CAD to trade in relatively tight ranges next week as markets may still fail to take a decisive direction in terms of risk appetite.

## CHF: ABB deal to drive CHF demand?

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/CHF | 1.0626 | Mildly Bearish | 1.0600 - 1.0700 | 1.0700 |

- EUR/CHF continues to trade heavily despite BTP-Bund spreads trading inside of 170 basis points. No doubt, the ECB's large balance sheet expansion is playing a role here. For the week ahead, the Swiss calendar will see June FX reserves and the June unemployment rate, expected to rise to 3.6% from 3.4%. News on the EU Recovery Fund will also play a role in EUR/CHF pricing.
- Away from the macro story, investors may well focus on ABB's announcement about share buybacks using the $7 billion proceeds from its divestment of its power grid assets to Hitachi. Presumably, the Swiss National Bank would seek to absorb large CHF buying – since deflation is getting worse in Switzerland and the popular KOF leading indicator failed to register much of a bounceback in June.

## SEK: Staying stable

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/SEK | 10.4710 | Neutral | 10.3550 - 10.5980 | 10.5000 |

- The relatively lower beta, high real rate nature of the Swedish krona (vs its cyclical G10 peers) provides a cushion to the currency during fluctuating markets. We expect EUR/SEK to stay around the 10.50 gravity line in the current summer lull before embarking on a depreciation trend later in the year.
- Despite the modestly dovish bias of the Riksbank July meeting, the effect on SEK has been muted, as interest rates are unlikely to move into the negative territory and the expansion of quantitative easing did not come as a complete surprise (the timing of the decision may be, but not the expansion itself). It is a very calm week on the Swedish date front. The May industrial production figures (Tuesday) should not impact SEK too much.

## NOK: Looking through the June inflation

| | Spot | Week ahead bias | Range next week | 1 month target |
|---|---|---|---|---|
| EUR/NOK | 10.6690 | Neutral | 10.5230 - 10.8870 | 10.7000 |

- June CPI (Friday) will be the key point of focus on the Norwegian data front, but the fairly unchanged inflation dynamics should have a limited impact on the krone. Rather, what matters more for NOK is the general risk environment. Indeed, the krone was the best performing G10 currency this week, following the rise in stock markets.
- While the mix of a possible near-term pause in the risk asset rally (given the rise in Covid cases in the US) and generally lower liquidity during the summer may translate into limited near-term NOK gains, we look for lower EUR/NOK later this year as a supportive risk environment and gradually rising oil price should both benefit the currency.

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