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Article

G10 FX: What to expect around Christmas

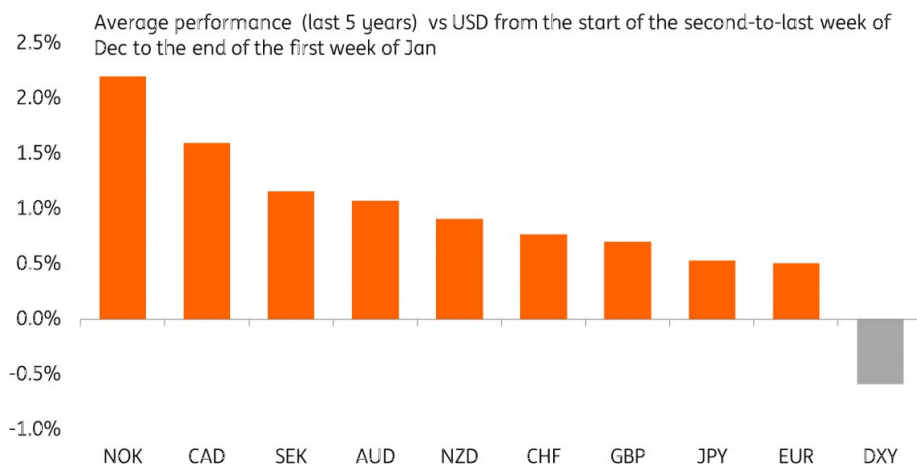
We look at seasonal tendencies and current market drivers to gauge the direction of G10 currencies in the normally low-volatility Christmas holiday weeks. We think the yen and Swiss franc may stay supported on unstable risk sentiment, NOK may emerge as the surprise outperformer thanks to surging gas prices, while EUR/USD may flatten around 1.1300



Note: Our FX Daily publications will resume on Tuesday, 4 January

The week before and the one after Christmas are notably a low-volatility period for most asset classes including FX. This year some seasonal tendencies will be mixed with the Omicron variant threatening to force new restrictions and markets still processing a week full of key central bank decisions.

A look at the last five years of trading around Christmas and the first week of January show that the dollar has a tendency to stay offered against the rest of the G10 currencies. Oil-sensitive FX (CAD and NOK) were normally well supported into the new year. In the article, we look at how recent developments may cause deviations from these tendencies.



Source: ING, Refinitiv

EUR/USD: Flattening up into the new year

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1300	Neutral	1.1250 - 1.1350	1.1200

- The hawkish shift in the Fed's tapering plans and Dot Plot projections seems to be showing its beneficial effects on the dollar with some delay. Despite the ECB being less dovish than expected, last week's central bank meetings marked a stark policy divergence with the Fed. And while the Fed's focus seems to have dramatically shifted to the inflation discussion, the ECB will struggle to overlook the Omicron impact – which is already translating into strict lockdowns in some eurozone countries. We think this is a notion that will offer a bearish underlying narrative to EUR/USD in 2022.
- As shown in the chart above, the dollar tends to underperform around Christmas. That relates to the greenback's broader tendency to underperform in December, which has often been linked to US corporates moving money offshore before the end of the year for tax reasons. However, we think that the recent hawkish turn by the Fed and unstable risk sentiment can mostly offset the negative effect. On the EUR side, we doubt we will see any idiosyncratic rally as the eurozone appears more likely than many other regions (like the US) to tighten containment measures. Incidentally, the EUR is on average the least likely to benefit from any dollar weakness around the end of December.
- Data-wise, we expect a strong read in November's durable goods orders this week, which should endorse the US strong growth outlook. Markets will also monitor the ongoing debate in Washington around Biden's spending bill, where more opposition to the bill could keep a lid on the dollar. The eurozone's calendar is set to be rather quiet in the next couple of weeks. All in all, we expect EUR/USD to consolidate around the 1.1300 level into the new year.

JPY: Room for a short-term short-squeeze

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	113.60	Mildly Bearish	112.80 - 113.90	114.00

- 10Y Treasury yields may struggle to move back above 1.50% as Omicron-related news keeps fuelling defensive trades. Despite not having a supportive seasonal trend around Christmas, we think that the risks are skewed to the upside for the yen in the next two weeks as the Omicron situation looks likely to get worse before getting better.
- The yen's positioning has remained skewed towards oversold territory (latest CFTC data showed net positioning at -30% of open interest) despite the Omicron impact. We think we could see some short-term weakness in JPY, which may pull back below 113.00. Still, we expect any JPY strength to prove temporary as the Fed tapering and tightening should put upward pressure on UST yields and energy prices should stay elevated.

GBP: The domestic picture is rather grim

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3240	Mildly Bearish	1.3170 - 1.3270	1.3100

- The surprise rate hike by the Bank of England last week has offered only some time-limited support to the pound. The fast spread of the Omicron variant in the UK may keep some pressure on GBP around Christmas, in particular as the government may opt to impose some new restrictions. Potential political turmoil may also weigh on GBP, as markets attempt to re-assess both the Brexit policy and the stability of the Johnson Cabinet after the resignation of Brexit chief negotiator David Frost.
- Still, the pound was quite oversold before the BoE meeting last week and given it is now back to pre-meeting levels, its positioning is likely still overstretched to the short side. We think this could help limit GBP losses, but the risks still appear moderately skewed to the downside.

AUD: China and iron ore offer some help

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7120	Neutral	0.7100 - 0.7180	0.7150

- China's latest efforts (including a surprising PBOC loan prime rate cut) to support the domestic economy have turned the narrative to a more supportive one for China-sensitive currencies like AUD. In the commodities sector, latest developments in China are fuelling a rally in iron ore, as hopes that steel restrictions will be eased seem to be brightening the demand outlook.
- We think all this can help shield the Aussie dollar – which is also looking at an overstretched net-short positioning – from the blows to global risk sentiment caused by the Omicron variant spread. AUD/USD may find some good support at 0.7100.

NZD: A bit more downside risk than AUD

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6750	Mildly Bearish	0.6700 - 0.6780	0.6800

- Although NZD could also benefit from improved Chinese growth sentiment, it cannot count (unlike AUD) on an ongoing rally in a main commodity (like iron ore for AUD) and despite a major change in positioning that sent NZD into oversold territory, net-shorts are at around 14% of open interest compared to the more skewed 40% of o.i. in AUD.
- We think this leaves NZD a bit more vulnerable to the hostile risk environment, although we think the 0.6700 support in NZD/USD should hold by the end of the year.

CAD: The fall can stop now

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.2940	Neutral	1.2880 - 1.3000	1.2700

- We think the recent underperformance of the Canadian dollar compared to its G10 peers is overdone and not warranted by any divergence in fundamentals. On the contrary, we think that the hawkish turn by the Fed may lead to speculation that the Bank of Canada (that has already ended QE) will start hiking already in 1Q22.
- As shown above, there is also some tendency of the Canadian dollar to outperform around this period. Naturally, the current unstable risk environment make a CAD rally complicated, but we think that some stabilisation in USD/CAD after the recent rally is possible around Christmas – especially if oil remains anchored around the US\$70/bbl level.

CHF: A good Omicron hedge

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0400	Mildly Bearish	1.0350 - 1.0430	1.0400

- In the current market environment, it's hard to imagine the Swiss franc losing any support. Its role as the quintessential risk hedge to European risk makes it an attractive currency as Omicron cases and potential closures rise in the region.
- The SNB looks set to keep intervening in the FX market to curb CHF appreciation, but it might not draw a line in the sand in EUR/CHF (eg, at 1.04) given the very choppy risk environment. We see more downside risks to the pair into January.

NOK: Extra support from natural gas

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.1800	Mildly Bearish	10.0900 - 10.2300	10.0500

- Like CAD, there is some positive seasonality factor for NOK. On top of this, European gas prices continue to soar, this time due to a halt in Russian gas flows from a key route to Germany. Weather forecasts suggest the Christmas week is set to be a particularly cold one in Europe, which should also keep natural gas prices supported.
- We think NOK may also see some delayed benefit from the Norges Bank's December hike and while growing risk aversion will continue to give some support to EUR/NOK, we could see the pair edge lower in the next two weeks.

SEK: Still the black sheep in G10

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3100	Mildly Bullish	10.2700 - 10.3800	10.3000

- SEK is set to close the year as the worst performing G10 currency and we doubt the last few days of December will see a rebound in the pair.
- The high beta of the krona to eurozone-related sentiment at a time where many European countries are considering tougher restrictions means that the downside risks are set to persist into the new year. Domestically, keep an eye on retail sales figures this week after the Economic Tendency Survey contracted in December due to the Omicron impact.

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