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WEEK AHEAD BRIEFING NOTE

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"How Low Can the Dollar Go as the FED Back Away from Tightening?"

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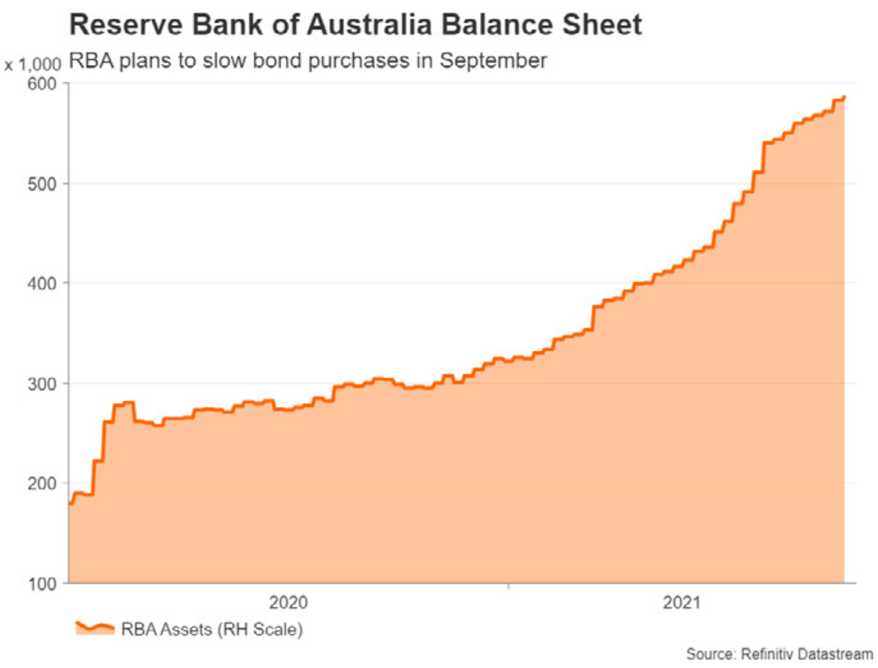
After the recent taper fever, the Fed may fall out of the limelight next week as other central banks take centre stage. The European Central Bank, Bank of Canada and Reserve Bank of Australia will hold their policy meetings. While a hawkish tilt is possible with the first two, the latter may lean in the opposite direction. With not a lot happening on the data front, the tapering timelines of each central bank looks set to dominate the market theme as September gets into full swing. But as expectations of an early Fed taper ease, will the US dollar continue its downslide or has the pullback gone far enough?

RBA taper plans on the line

The RBA will kick off next week's policy gatherings on Tuesday and its decision is probably the least predictable out of the three. Back in August, the RBA stuck to its tapering plans despite soaring Delta infections and expanding lockdowns in Australia. Policymakers are unlikely to make a last-minute U-turn on reducing the pace of bond purchases in September from A$5 to A$4 billion a week. However, they may hint at a delay to the next review, which is penciled for November.



Stronger-than-expected GDP growth in the second quarter and record exports in July have somewhat lowered the odds of the RBA dialing back on its plans. Another reason why policymakers may prefer not to overreact to the worsening virus picture just yet is that Australia's vaccine rollout has accelerated lately, raising optimism that the regional lockdowns could end soon.

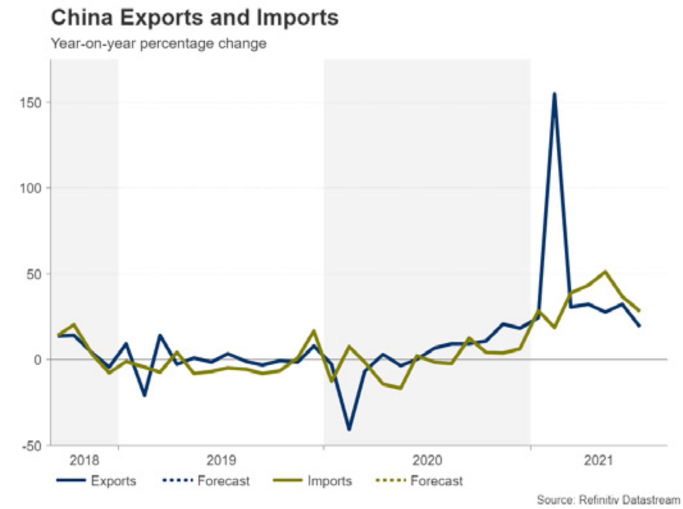
However, the country is far from being out of the woods as the virus surge is showing no sign of peaking and it could be a while before restrictions are eased, meaning a deep contraction in Q3 GDP may be unavoidable.

Looking at the Australian dollar's performance over the past couple of weeks, investors appear to have become less gloomy about the outlook. And although the aussie's revival is mostly to do with a weaker US dollar, most analysts see the RBA slowing its tapering process over a longer duration rather than postponing or even reversing it.

China slowdown risks

As investors cheer the shift towards a more patient approach by some central banks in withdrawing their pandemic era stimulus, Chinese trade data might inject a fresh dose of doubt into the outlook on Tuesday. Fears that China's recovery has lost considerable steam has been another weight on the aussie lately but rising hopes that more fiscal stimulus is on the way has alleviated some of the concerns.

If exports rise by less than expected in August, it could put a cap on the China-sensitive aussie's gains as well as take the shine off the recent rally in global stocks.

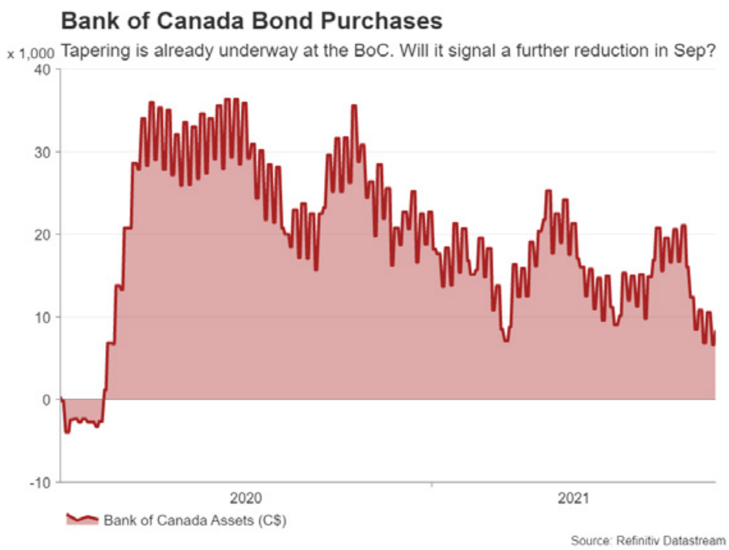


In addition to the trade figures, investors will also be keeping an eye on the consumer and producer price indices on Thursday out of China.

Bank of Canada to stand pat

The BoC's meeting on Wednesday is almost certain to be a non-event as the Bank is unlikely to announce any policy changes ahead of federal elections in Canada on September 20. However, the spotlight was always on October as this is when the Bank next publishes its quarterly economic projections and when policymakers are therefore likely to next review the pace of QE.

That's not to say, though, that there won't be any surprises next week. The Canadian economy unexpectedly shrunk in the second quarter and although the country's extremely high inoculation rate should protect it from the Delta variant, the economic fallout in other parts of the world could curtail Canada's own recovery, particularly as the price of oil is hit. These setbacks might make policymakers have second thoughts about signaling another cut in their weekly bond purchases, which is widely expected in October.

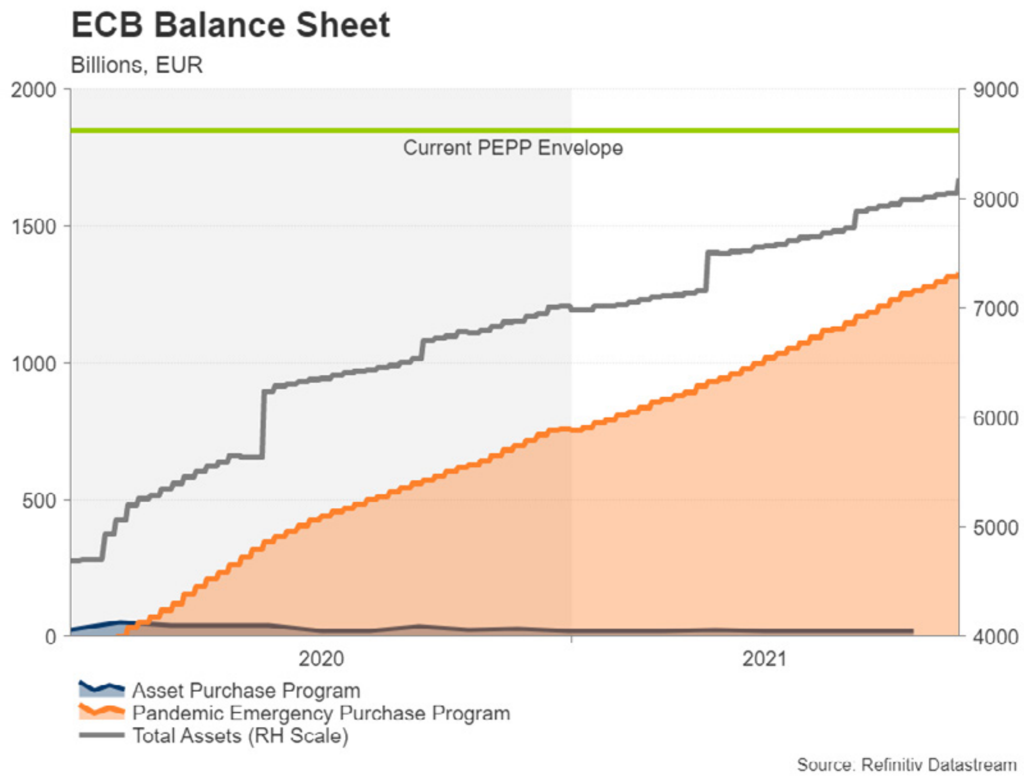


More clues about tapering in October could come from Friday's employment report for August. The Canadian dollar has posted a tepid rebound versus the greenback after brushing an 8-month low on August 20. But its overall trajectory has been bearish since June. The absence of fresh taper hints and a soft jobs report could reinforce that trajectory.

ECB taper talk heats up

Last but not least, markets are bracing for the ECB's decision on Thursday amid the hawkish voices getting louder lately. Despite some policymakers earlier playing down the prospect of a taper move in September, the signs are unmistakable – the ECB seems to be setting the stage for winding down its pandemic emergency purchase programme (PEPP). The start of tapering could be announced as early as next week. But how significant is this really for the markets?

The ECB's PEPP programme was always set to end in March 2022 so it's inevitable that the speed at which the purchases are being conducted has to scaled down at some point, especially as they've been running at a "significantly higher pace" since March. With the vaccination rate across the continent close to reaching the ranks of Britain and Canada and the Eurozone recovery on a more solid footing, some reduction next week shouldn't come as that much of a surprise.

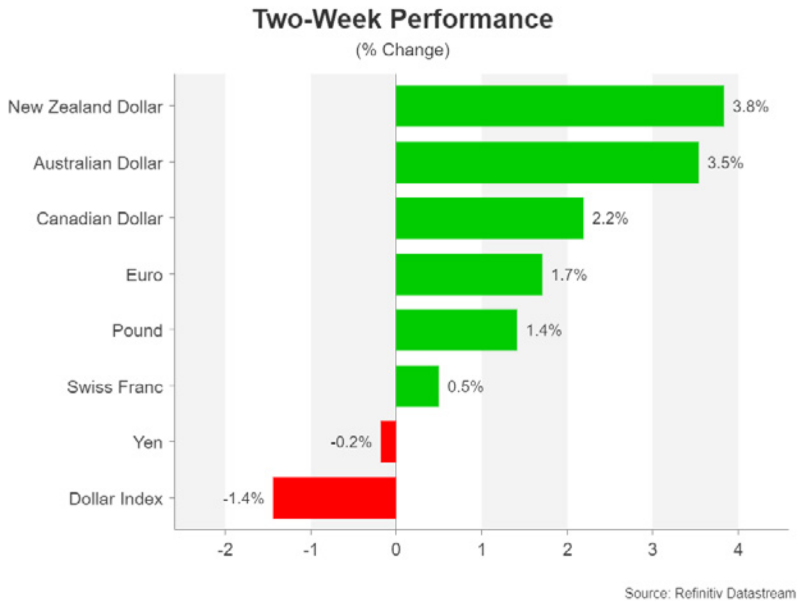


However, the tone that the ECB adopts will matter as there are a number of unanswered questions regarding QE, namely, will PEPP's €1.85 trillion envelope be used in full and will the regular APP programme be bumped up once PEPP ends? Hence, there is plenty of scope for substantial hawkish turns over the next few months even though there's no prospect of ECB stimulus stopping entirely anytime soon.

The euro could extend its recent gains versus the dollar if the ECB sets itself on the taper path, though traders will also be watching some key indicators out of the Eurozone's biggest economy – Germany – for fresh clues about the growth momentum. Industrial orders for July are due on Monday followed by industrial production and the ZEW economic sentiment gauge on Tuesday, and trade numbers on Thursday.

Pound might overlook UK data

Across the Channel, monthly readings on industrial production and trade will also be doing the rounds in the UK, along with the GDP estimate for July. The pound's rebound against the dollar has been more modest compared to its rivals' but it's doubtful how much of a boost next week's data could provide if there are any upside surprises. Investors are increasingly uneasy about the UK government's overly lax approach in lifting all virus restrictions amid rising Covid hospitalizations in recent weeks, which keep creeping higher.

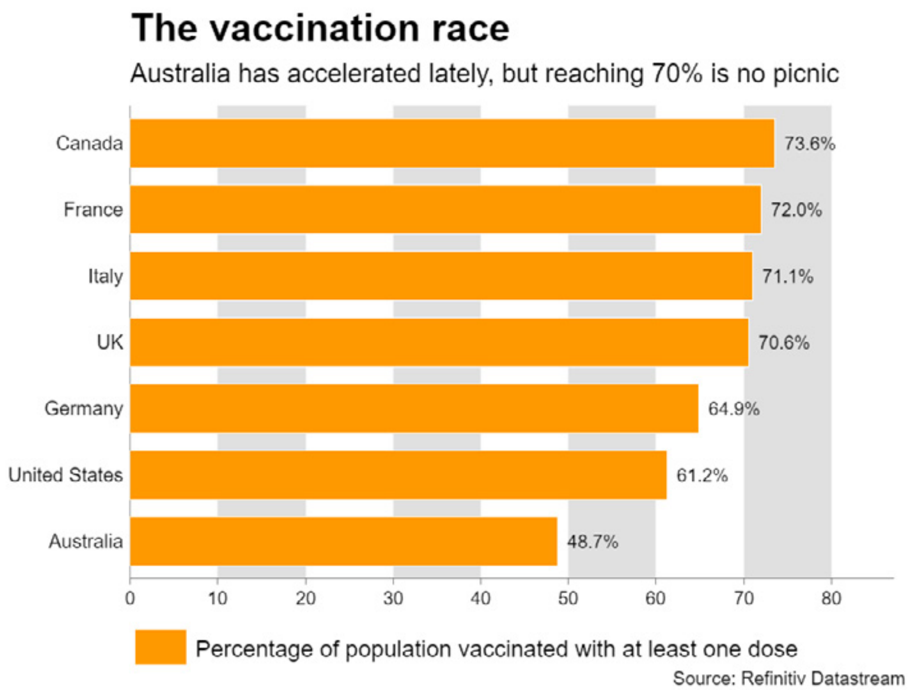


The Reserve Bank of Australia (RBA) will conclude its latest meeting at 04:30 GMT Tuesday. Markets are split on whether the central bank will stick to its taper plans or whether it will reverse that decision as lockdowns continue. The risks surrounding the aussie from this meeting seem tilted to the downside, as even a decision to push ahead with tapering might be seen as a policy mistake.

Dodging a recession

The past couple of months have been tough for the Australian economy, which has been grappling with strict lockdowns to control the Delta outbreak. This will inevitably hit economic activity in the third quarter, something already evident in PMI business surveys that cratered.

On the bright side, the economy was quite strong heading into this weakness, with the unemployment rate falling substantially and GDP data for the second quarter showing solid growth. That diminishes the risk of a technical recession, which is defined as two consecutive quarters of negative growth. Of course, this assumes things will turn around in the final quarter.

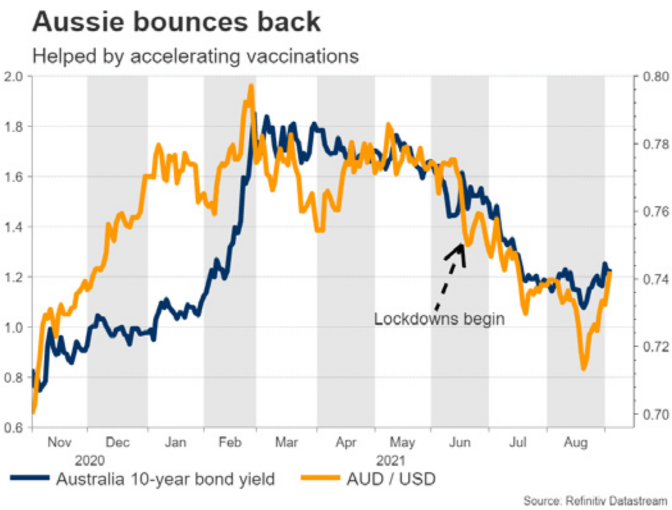


That's debatable. The government has stressed it wants to see the nation's vaccination rate hit 70 - 80% before relaxing any restrictions. While vaccinations have been accelerating lately, that's a difficult target to hit. Most of Europe is still around 70% while America is even lower, despite starting much earlier.

RBA reversal?

When the RBA last met in early August, it decided to stick to its plan to reduce asset purchases despite the lockdowns. The logic was that previous shutdowns didn't hit the economy that hard and if things worsened further, policymakers could always change their mind.

There is no doubt things have worsened and the economy looks set to take a much bigger hit than previously anticipated. To make matters worse, iron ore prices continue to fall and China is also slowing down. This is crucial since iron ore is one of Australia's biggest exports and China is the nation's biggest customer for that.



So what will the RBA do this time? Admittedly, the most prudent approach would be to pause the normalization plans for now. It made sense to reduce stimulus a few months ago, but not anymore. Pushing ahead with those plans would save the RBA some face, but it would be a very questionable move from a risk management perspective as it could exacerbate the ongoing economic hit.

Market reaction

As for the aussie, it is difficult to envision a scenario where the currency rallies powerfully after this meeting. Either the RBA will pause its tapering plans, sending a dovish signal that hits the aussie, or it will push ahead with normalization regardless of the worsening outlook. That may be seen as a policy mistake and therefore limit any upside in the currency.

Another middle-of-the-road solution would be for the central bank to reduce its asset purchases, but signal that it won't cut them again for a while, at least until the economy is out of the woods. That's a relatively neutral outcome for the FX market.

Turning to the technical picture, aussie/dollar has staged a strong comeback over the past couple of weeks, capitalizing on a softer US dollar as well. If the bulls remain in control, the next target may be the 0.7530 region.

On the flipside, if the RBA backpedals on its taper ambitions, the pair could edge back below the 0.7415 zone. If so, the focus would then turn towards the 50-day moving average, currently at 0.7374.

US Open Note – Dollar in tears after NFP; euro touches 1.1900

Nonfarm payrolls miss forecasts; dollar down

US nonfarm payrolls took center stage on Friday, presenting an employment growth of 273k for the month of August, which was way below the forecast of 750k but still enough to press the unemployment rate to 5.2% as expected and let wages to spike faster than analysts anticipated by 4.3% m/m.

Despite some early warnings from the private ADP employment report and the ISM PMI business readings this week, the data spooked markets as hopes for a September bond tapering announcement hit a wall, leaving investors wondering which of the two remaining policy meetings the Fed will decide to wrap up its stimulus reduction plans.

According to Fed speakers, the central bank was looking for an employment growth of 1.6 – 2.0mln in total in the July and August readings, though today's data could not pass that bar, shifting the weight to September's NFP numbers due early in October, which in turn could support a November taper announcement.

The negative surprise in jobs figures brought the upside down in US Treasury yields, with the 10-year yield diving to an almost two-week low of 1.2668% before flying to an intra-day high of 1.3229% .

Consequently, the US dollar index corrected aggressively to a fresh one-month low of 91.91 in the aftermath before inching slightly above the 92.00. Dollar/yen crossed below the key 109.83 support level, though marginally. Perhaps Prime Minister Yoshihide Suga's resignation kept some floor under the yen as investors speculate his successor could boost fiscal support after this month's general election.

Euro breaks August highs ahead of ECB

The plunge in the dollar bolstered the rally in the European currencies. Euro/dollar sped up to top slightly above its August peak at 1.1908 ahead of next week's ECB policy meeting. An unexpected increase in Eurozone CPI and PPI figures raised fears of a more persisting inflation, forcing ECB officials to call for some reduction in the Pandemic Emergency Purchase Programme (PEPP) at next week's gathering. Given that there is no clue about how temporary or persisting the rise in prices could be, any hawkish tweaks in the ECB communication next week could trigger another bullish wave in the euro.

Aussie eyes RBA policy decision

The aussie will also be under the spotlight next week as the RBA will also be in a dilemma on Tuesday about whether it should move forward with its taper plans or postpone any decision to November's gathering. Better-than-expected Q2 GDP growth figures and some progress in the covid situation hinted at some hawkish turns in the RBA, though with lockdowns in some regions remaining intact and China's recovery being at risk in the face of the delta variant, policymakers could stand pat on policy. If the Bank sticks to its plans and express a more optimistic view about the economy, aussie/dollar could extend its upleg beyond the key 0.7497 -0.7528 resistance.

Pound, loonie gain little ground

The pound and the Canadian dollar could not steal significant ground from the greenback. With the UK and Canada creating few headlines this week, pound/dollar could only edge up a few pips to 1.3866, while dollar/loonie remained squeezed between its 50- and 200-day SMAs at 1.2525. Note that Bank of Canada will also set its policy next week, but expectations are for an uneventful gathering.

Gold showed a muted reaction as well, unable to reach the key 1,835 resistance territory.

Wall Street opened broadly neutral, while the pan-European STOXX 600 was heading for a negative close.

Weekly Comment – EUR gets lift from USD woes, eyes more hawkish ECB

USD's losses accelerated this week, with a big NFP miss exacerbating the pain. But there's not much prospect of a quick bounce back in USD as it's looking like a very light calendar over in America. But it will be quite busy elsewhere. The ECB, BoC and RBA all meet and will likely be discussing tapering, one way or another.

The highlights:

- The ECB meets on Thursday and could decide to ditch its commitment of "significantly higher pace" of asset purchases. However, unless policymakers clearly flag additional tapering down the line, EUR's gains might be limited.
- The RBA will probably discuss taking its tapering plans in the opposite direction. Extended lockdowns are expected to plunge the Australian economy into a deep contraction in Q3. A delay to the November review of the pace of bond purchases is likely. A reversal of the September reduction is also possible but might come as a surprise, potentially derailing AUD's rebound.
- The BoC is almost certain to hold policy unchanged in September. But although Canada's recovery is coming along nicely, external headwinds might prompt policymakers to sound more cautious and cast doubt on further tapering in October. Hence, there are some downside risks for CAD from the meeting.
- Gold finally has a stronghold above the $1,800/oz mark and after the NFP bruising for USD, the door is open for more gains next week.
- Wall Street looks poised for more record highs in the coming days as the Fed will probably wait until November to announce tapering.

Technical Analysis – WTI oil futures take a breather after one-month high

WTI oil futures (October delivery) flipped a three-day decline on Thursday to bounce back above their simple moving averages (SMAs) on the four-hour chart and hit a one-month high of 70.59.

The upturn in the price stalled immediately after the RSI touched its 70 overbought level, which has been a strict barrier since June, but the indicator continues to fluctuate comfortably above its 50 neutral level, suggesting the bulls have not abandoned the game yet. The MACD, having slowed pace, remains above its red signal line, keeping the short-term bias tilted to the upside as well. Should the price advance above the peak of 70.59, a more challenging obstacle could pop up around the 61.8% Fibonacci level of the 76.20 – 61.77 downleg at 71.50. A tentative resistance trendline is passing through this region. Therefore, an upside breakout at this point could add extra fuel to the rally, boosting the price up to the 78.6% Fibonacci of 73.00. Running higher, the next stop could be somewhere between 74.20 and 74.85, taken from the highs on July 30 and July 13, respectively. If selling pressures resurface, immediate support could develop near the 20-period SMA and the 50% Fibonacci of 68.91. Failure to rebound here may drive the price towards the 38.2% Fibonacci of 67.22, a break of which could see some consolidation around the 66.00 psychological level. The 23.6% Fibonacci of 65.15 could next show up on the radar.

In brief, despite the latest minor pullback, WTI oil futures seem to have some bullish fuel left in the tank. The question now is, will this be enough to pierce the 71.50 ceiling?

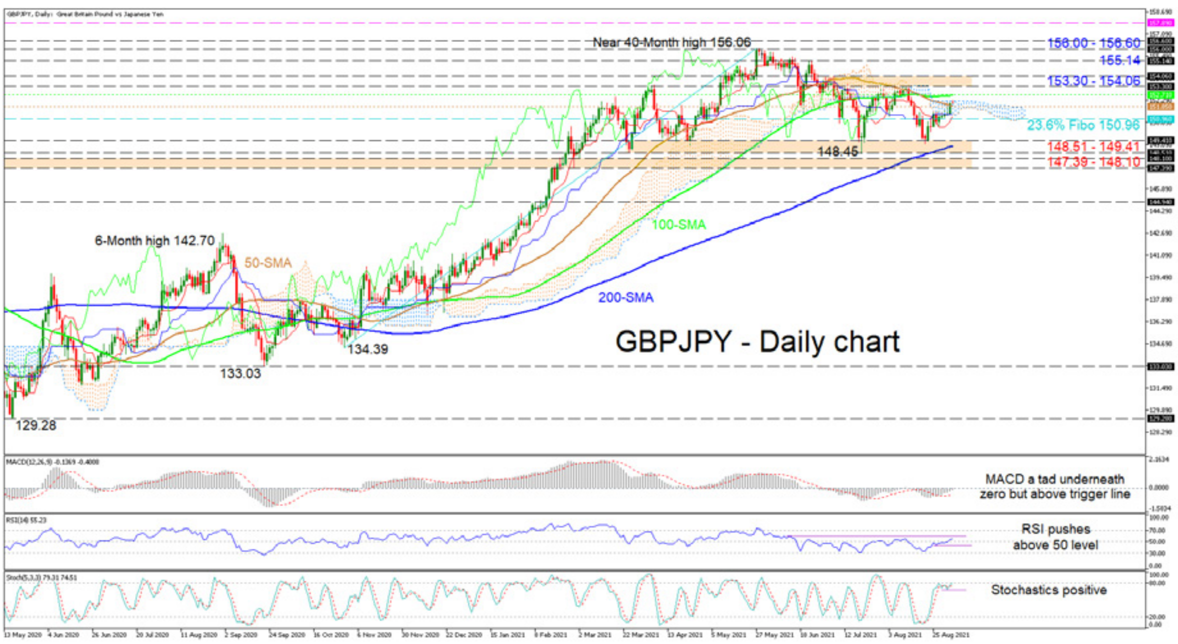
Technical Analysis – GBPJPY improves after bounce around familiar floor

GBPJPY, although having nudged over the 50-day simple moving average (SMA) at 151.85, has yet to overstep the Ichimoku cloud's upper surface, residing between the 50-and 100-day SMAs. The 100- and 200-day SMAs are backing a positive picture, while the 50-day SMA is endorsing a phase of consolidation along with the unclear Ichimoku lines. That said, the short-term oscillators are suggesting that bullish momentum is ahead. The strengthening MACD has neared its zero mark after pushing above its red trigger line, while the RSI is improving in bullish territory. The stochastic oscillator is maintaining a positive charge around the overbought region promoting bullish price action in the pair.

If the pair steers above the Ichimoku cloud, early resistance could commence from the 100-day SMA at 152.71 ahead of the resistance belt of 153.30-154.06. Should buyers manage to clear this ceiling relating to the recent consolidation - the price may then target the 155.14 high from around the end of June. If upside momentum persists, the resistance section between the 156.00 handle and the rally peak of February 2018 at 156.60 could come into focus.

Otherwise, if sellers drive the price below 151.85, next support could arise around 150.96, which happens to be the 23.6% Fibonacci retracement of the up leg from 134.39 until 156.06. Additional weakness may direct the pair back to the vicinity of the support base of 148.51-149.41, where the pair previously found its footing. However, if this foundation breaks down, which encapsulates the 200-day-SMA, the next obstacle to conquer could be the nearby 147.39-148.10 border.

Summarizing, GBPJPY is sustaining a positive bearing in a sideways pattern between 148.51 and 153.30. A break above 154.06 or below 148.51 could set a clear price path.



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