Our View on Currencies

Edition May and June 2022

VP BANK

Our View on Currencies - Overview

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Our View on **EUR/USD**

1.05 - 1.10

Expected range
for 3 to 6 months

- The potential for monetary policy surprises is on the side of the ECB
- The euro is undervalued from a purchasing power parity perspective
- The high US twin deficit is a burden for the USD

- Interest rate hikes despite falling inflation rates and increased real interest rates support the USD
- Geopolitical uncertainties lead to continued flight to safe havens

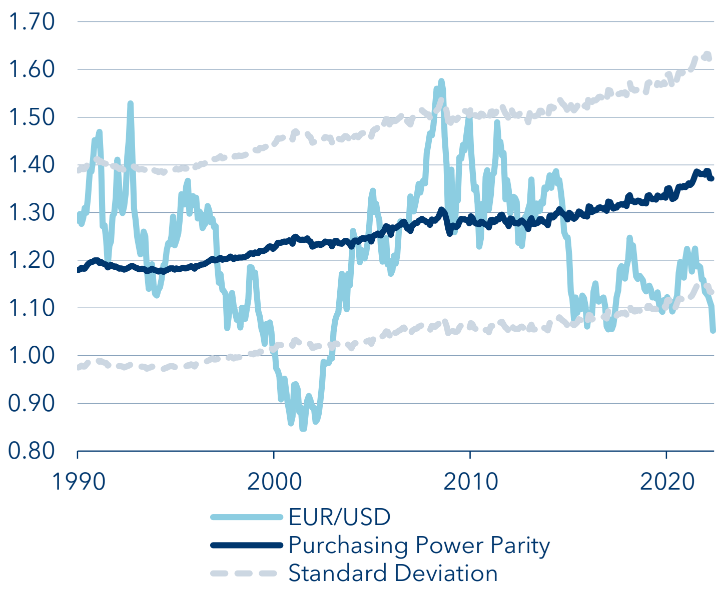
Expensive dollar

The dollar is currently the undisputed number one in the currency universe. The aggressive monetary policy swing of the US central bank Fed and the war in Ukraine make the greenback not only a safe haven but also an investment currency. But the European Central Bank (ECB) may have to shift up a gear. The potential for monetary policy surprises is therefore clearly on the side of the ECB. Moreover, the technical situation is overstretched, which argues for a correction after the recent dollar appreciation. Looking ahead over the next three to six months, we continue to expect higher prices for the EUR/USD currency pair. However, we are adjusting our forecast range downward due to the latest market movements.

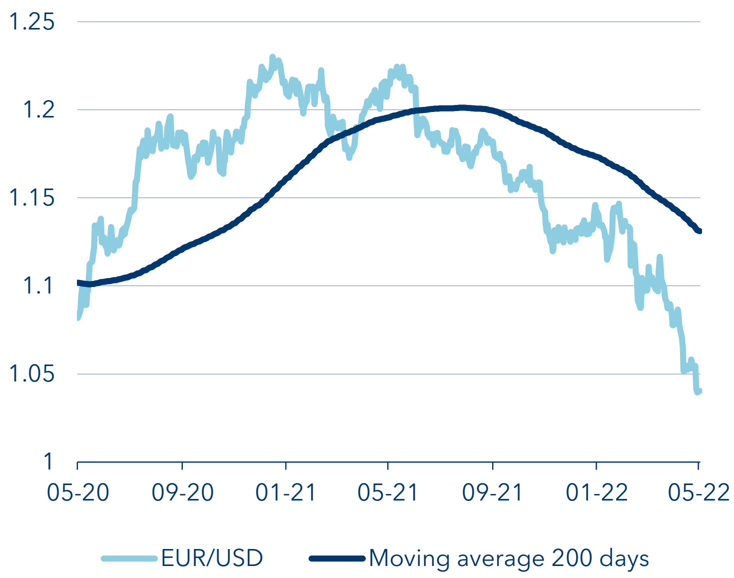
Our View on **EUR/USD**

1.05 - 1.10
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/CHF**

1.00 - 1.07
Expected range
for 3 to 6 months

- The SNB is preparing monetary policy changes and could even raise the key interest rate earlier than the ECB
- The Swiss franc is hardly overvalued anymore, which limits the depreciation potential

- Should the ECB launch an aggressive monetary policy turnaround in the coming months, this would argue for a stronger EUR
- The weak EUR improves the competitiveness of the euro zone

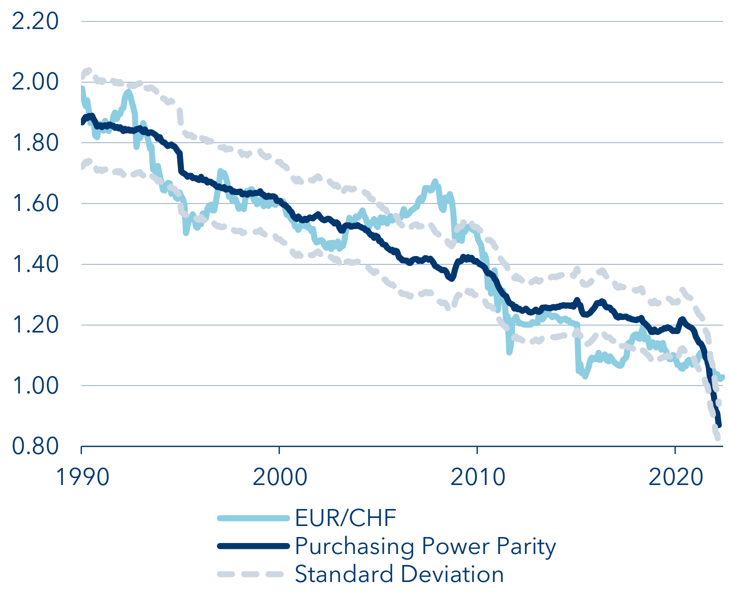
SNB might be prepared for a move soon

The Swiss National Bank (SNB) is about to change its monetary stance. Its president Thomas Jordan recently stressed that there is a risk of second-round effects if inflationary pressures persist. Judging by the relaxed choice of words in recent months, this is close to a U-turn. The SNB now faces a problem with its meeting schedule. The next policy meeting will be held in June, the following one won't occur until September. Therefore, it cannot be ruled out that an interest rate hike will be decided as early as June. If the SNB sends more signals for a monetary policy change and might even be moving its stance before the ECB, a further appreciation of the Swiss franc in the short term may occur. Due to the surprisingly early turnaround by the SNB, we are adjusting our exchange rate target range.

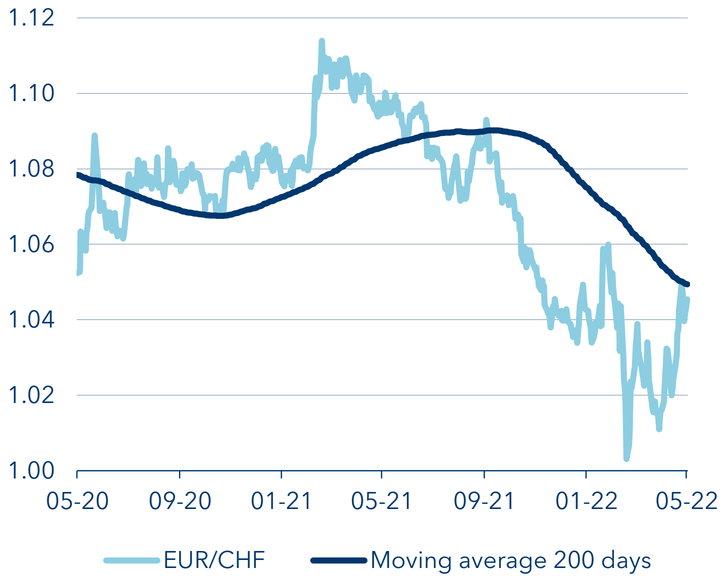
Our View on **EUR/CHF**

1.00 - 1.07
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **USD/CHF**

0.95 - 1.00

Expected range
for 3 to 6 months

- The Fed's monetary tightening supports the dollar
- Both currencies are in demand in times of high uncertainty

- Political uncertainties are mounting in the US ahead of the midterm elections in autumn
- High US twin deficit is a burden on the dollar

Dollar appreciates even against the Swiss franc

The dollar also had a good run against the franc. While the Fed has already implemented its aggressive monetary policy turnaround, Switzerland is still holding back. The Swiss National Bank (SNB) has not yet shown any ambition to abandon its policy of negative interest rates. Thus, the Fed and the SNB could hardly be more different. But the recent dollar strength now seems overstretched. The technical market situation argues for a weaker greenback in the coming months. Moreover, the current exchange rate of the dollar already reflects the interest rate hikes promised by the Fed so far. Thus, the surprise potential lies with the SNB. The Swiss inflation rate of 2.5% doesn't fit well with a negative interest rate of –0.75%. The SNB will probably have to hold out the prospect of somewhat higher key rates for the next six months. This will help the franc.

Our View on **USD/CHF**

0.95 – 1.00

Expected range
for 3 to 6 months

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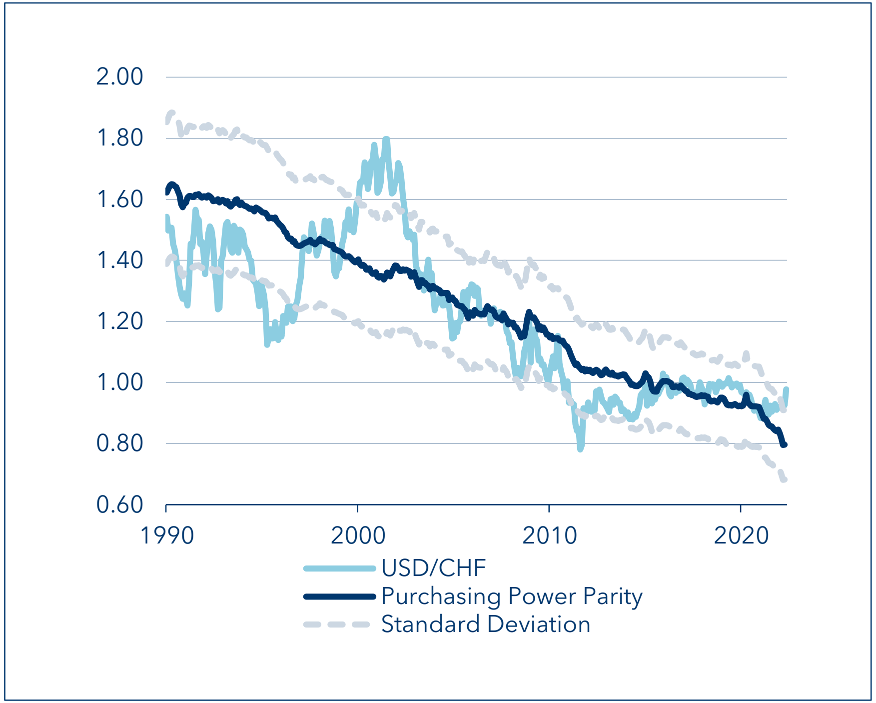
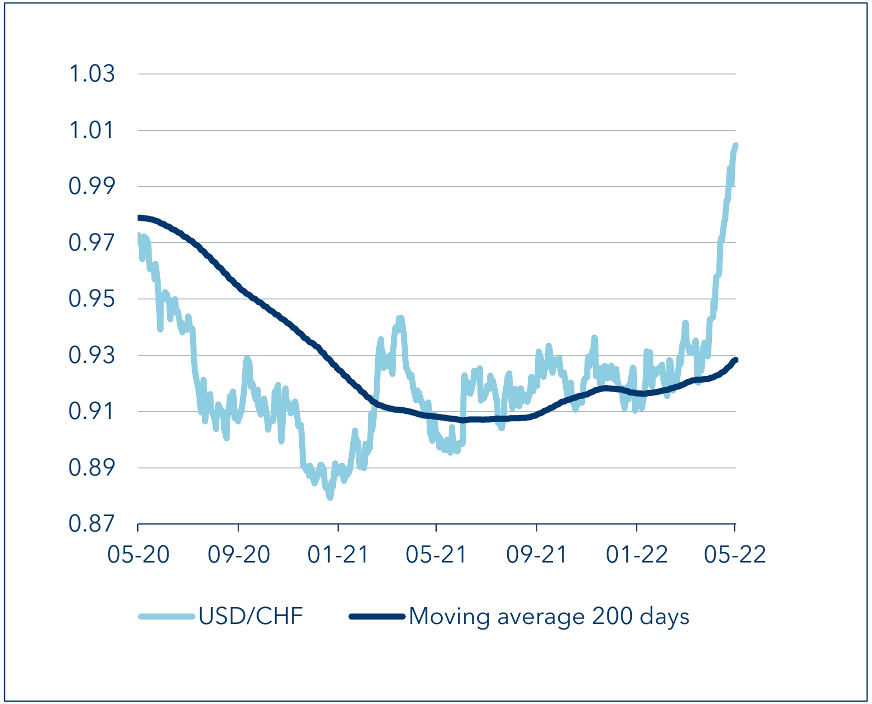


Technical view



Our View on **GBP/USD**

1.25 - 1.30

Expected range
for 3 to 6 months

- The pound shows a glaring undervaluation against the dollar
- On the dollar side, the Fed's rate hike path is largely priced in

- Brexit reduces the UK's potential growth, which argues against significant pound appreciation
- The Pound remains under pressure due to possible weaker economic development in the UK

Low pound

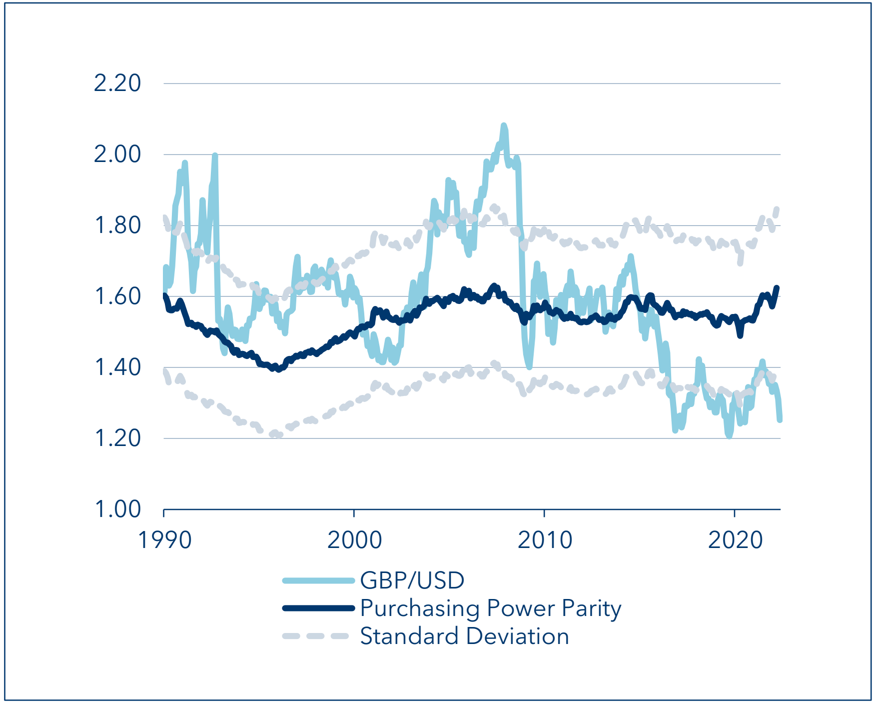
British inflation rates will continue to rise. The Bank of England (BoE) itself expects the rate to peak at around 10% towards the end of the year. At the same time, the labour market should continue to recover. However, the economic outlook is becoming gloomier. High inflation rates are weighing on private consumption. The British central bankers will continue to raise interest rates in the coming months. However, the emerging economic weaknesses could force the BoE to adopt a more cautious monetary policy course compared with the US Federal Reserve. It is precisely the BoE's more cautious course that could, for the time being, counteract a significant recovery of the pound. However, the pound is blatantly under-valued against the dollar, which argues for higher exchange rate levels of the GBP/USD currency pair in the coming three to six months.

Our View on **GBP/USD**

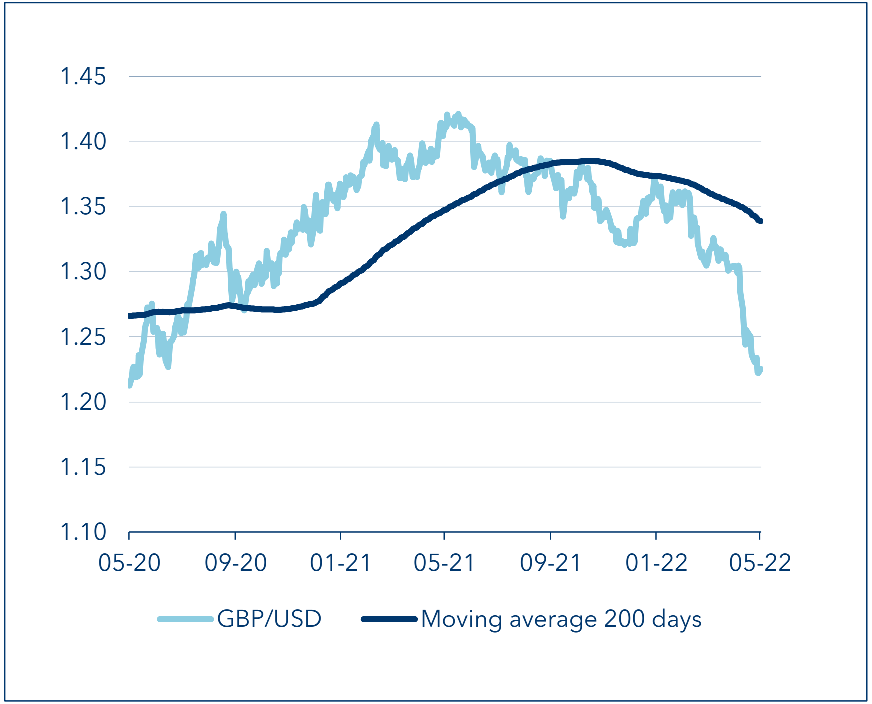
1.25 - 1.30

Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/SEK**

10.00 - 11.00

Expected range
for 3 to 6 months

- The Riksbank changed the monetary policy direction in April
- Currently still unfavorable environment for high-beta currencies like SEK

- If the Riksbank initiates a significant change in monetary policy, it will trigger SEK appreciations, which would go against the sideways movement we are expecting
- The ECB launches more and faster rate hikes than previously assumed

Riskbank delivers

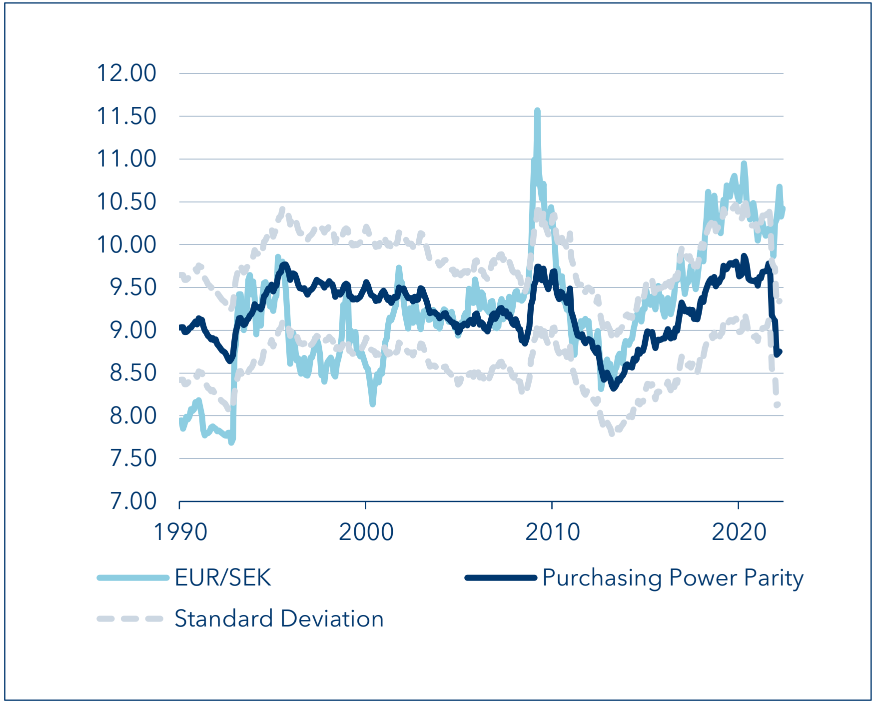
The change in monetary policy implemented by the Swedish central bank (Riksbank) helped the krona somewhat against the euro. The Riksbank raised the key interest rate to 0.25% in April and expects two or three more steps this year. At the end of its forecast horizon, i.e. toward the end of 2024, it predicts a key interest rate of just below 2%. It has thus pulled its key interest rate path significantly forward. It is also reducing its bond holdings from the middle of the year. Since a lot of positive things were already priced into the SEK before the April meeting due to the restrictive comments of the council members, the krona has little appreciation potential left. Moreover, the ECB will probably also carry out the first interest rate hikes in summer. We expect the EUR/SEK currency pair to move sideways over the next three to six months.

Our View on **EUR/SEK**

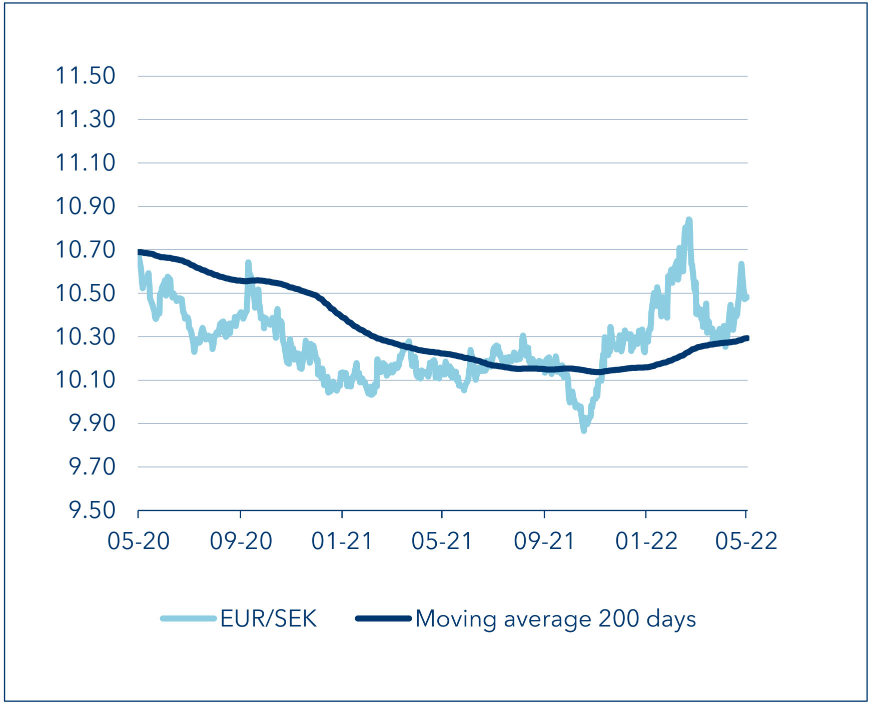
10.00 - 11.00

Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Authors and Disclaimer

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On Purchasing Power Parity: The Purchasing Power Parity (PPP) describes that a product costs the same in two countries as long as it can be traded without restrictions and the transaction costs are negligible. The relative PPP used here is based on producer price indices and assumes that the prices of the products change by the same amount, taking into account the exchange rate, but that the price levels may differ.

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