Our View on Currencies

Edition April and May 2023

VP BANK

Our View on Currencies - Overview

Currency pairs

Our View on **EUR/USD**

1.07 – 1.15
Expected range
for 3 to 6 months

- Monetary policy support for the dollar is weakening
- ECB maintains its path of interest rate hikes for a longer period of time
- Speculative forward sales of the euro are unwound

- If the Fed were to continue raising interest rates for a longer period, the dollar could gain again
- Emerging financial market stress helps the US dollar in its safe haven function
- A weakening ECB in the fight against high inflation rates could stand in the way of a further euro recovery

EUR/USD: No clear trend discernible

The EUR/USD exchange rate pair has gone up and down in recent weeks. This already shows that there is disagreement on the currency markets about the right direction. On the one hand, there is the fear of greater trouble on financial markets, which strengthens the dollar in its function as a safe haven. On the other hand, the Fed has reached the end of its interest rate hikes, while the ECB should go even further. The European monetary policymakers have simply done relatively little compared to their US counterparts. However, the outlook for further interest rate hikes in the eurozone has not been effective on the currency markets lately, as the ECB wants to act depending on the data and is keeping all options open. However, we stick to our view and see the ECB under pressure to act, which should tend to help the euro in the coming weeks.

Our View on **EUR/USD**

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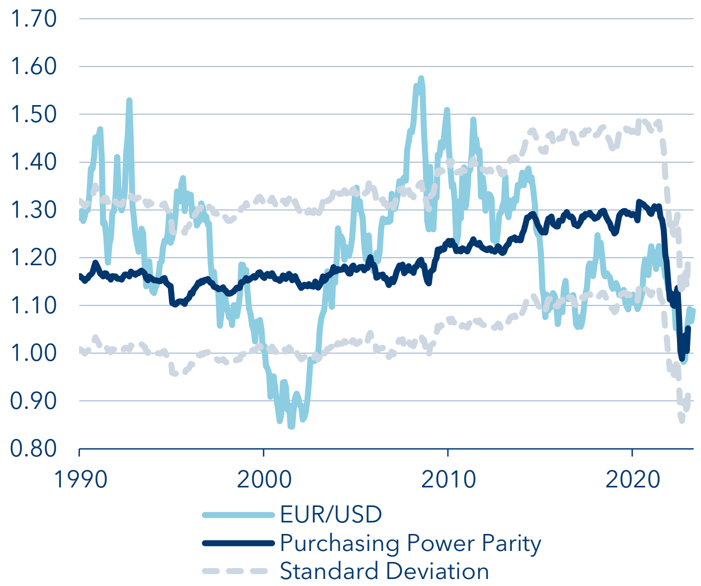
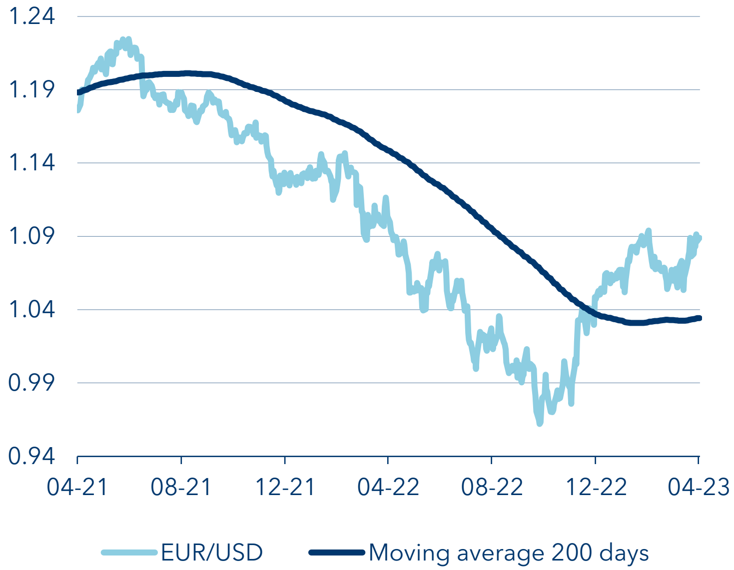
Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/CHF**

0.98 – 1.04
Expected range
for 3 to 6 months

- Euro benefits from continued ECB monetary policy tightening
- The SNB could exercise restraint regarding further interest rate hikes and thus weigh somewhat on the franc

- If the ECB falls short of market expectations, this could weigh on the euro in the coming months
- If there were to be a more pronounced slump in growth in the euro zone, this would have negative consequences for the euro.

Limited depreciation potential of the franc

The franc remained at firm levels with quotes below parity against the euro. Should the euro strengthen against the US dollar in the coming weeks, we also expect higher levels for the EUR/CHF currency pair. However, the appreciation potential of the euro is likely to remain limited. At its last monetary policy assessment, the SNB emphasised its willingness to intervene in the foreign exchange market. The focus has been on foreign exchange sales for several quarters. The SNB is thus reducing its foreign exchange holdings, which in principle strengthens the franc. The volumes used in this process are lavish. The SNB's balance sheet total has shrunk by around CHF 200 billion year-on-year. Precisely because of this intervention policy, the depreciation potential of the franc is likely to be limited. The 1.04 we listed in the forecast band should therefore be seen as the upper limit of possible franc devaluations.

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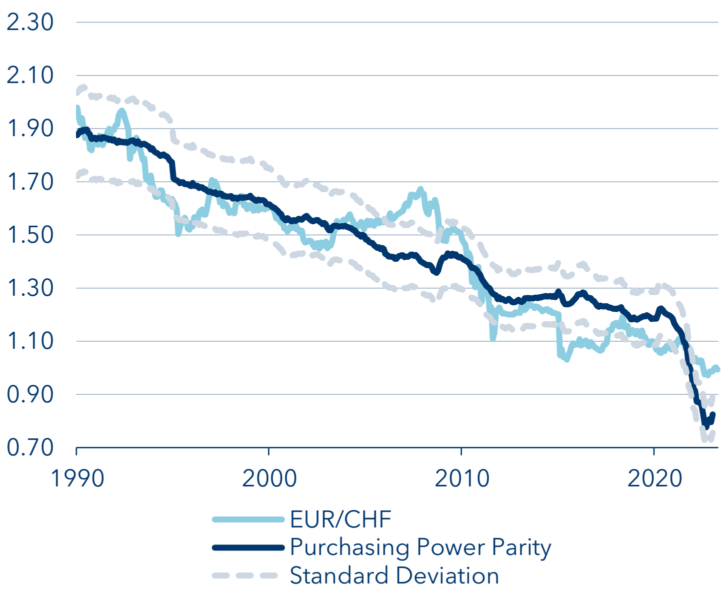
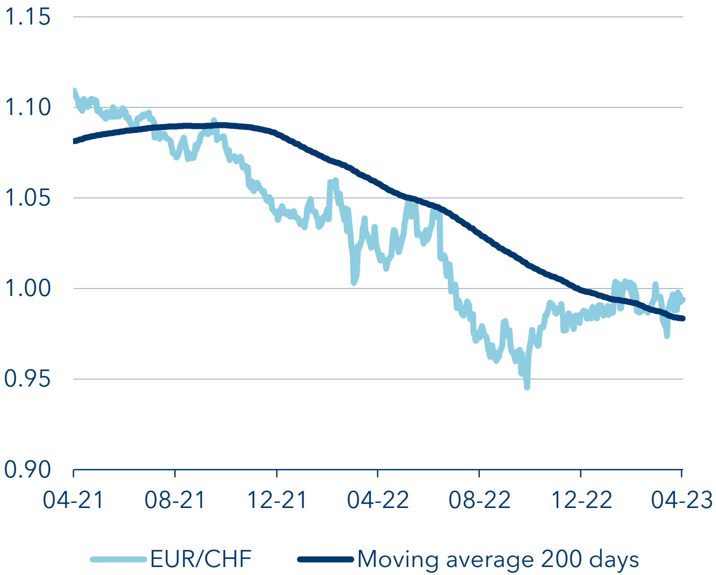


Technical view



Our View on **USD/CHF**

0.88 - 0.95
Expected range
for 3 to 6 months

- Monetary tightening by the US Federal Reserve supports the dollar
- Both currencies in demand in times of high uncertainty

- Fed to reach interim interest rate high shortly
- The high US twin deficits are a burden for the US dollar

US dollar: Further weakness expected against CHF

The Fed is heading for the end of its cycle of interest rate hikes. On the other hand, the dangers of recession are currently even more obvious in the US than on the European continent. The interest rate hikes will leave clear economic skid marks in the coming months. The turbulence in the US banking sector shows that the interest rate hikes will not remain without consequences. From a purchasing power parity perspective, the franc is favourably valued and would still have potential for further gains against the US dollar. The ongoing fall of US inflation rates in the coming months and the more clearly economic weakness becomes apparent, the more the dollar should weaken. We therefore expect the Swiss franc to make further gains against the US dollar.

Our View on **USD/CHF**

0.88 - 0.95
Expected range
for 3 to 6 months

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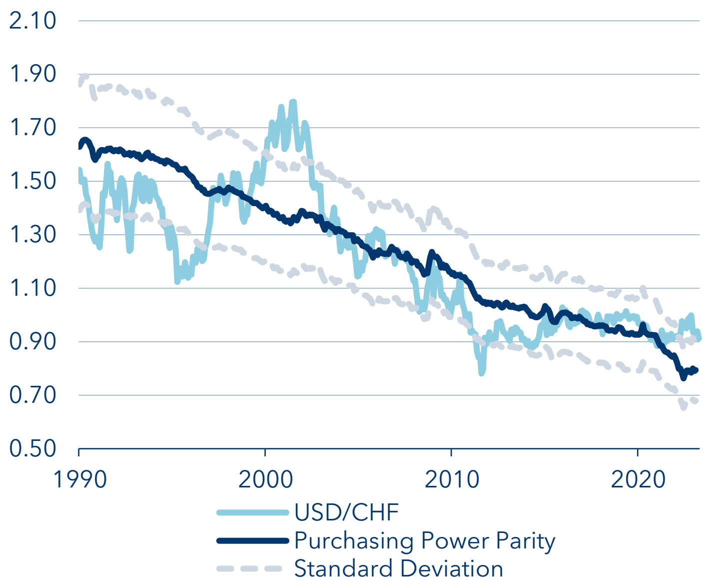

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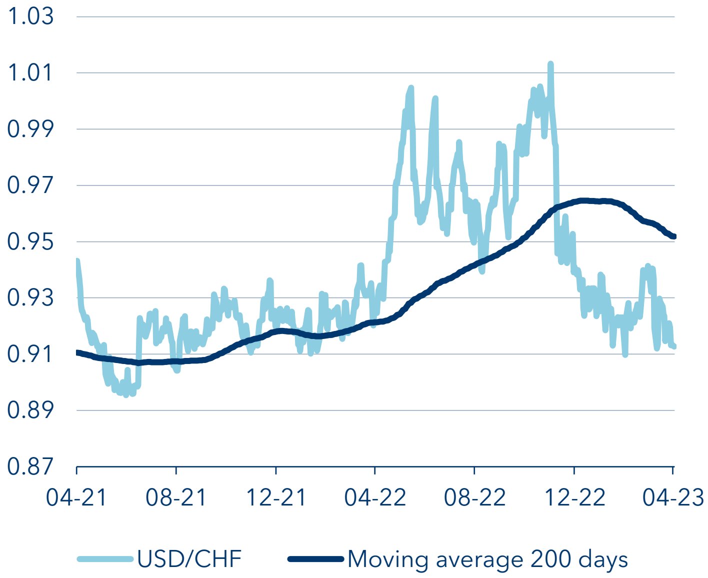

Our View on **GBP/USD**

1.15 – 1.25
Expected range
for 3 to 6 months

- Sterling is blatantly undervalued 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 a significant appreciation of the pound
- The pound remains fundamentally depressed due to a possible weaker economic development in the UK

Limited recovery potential for the pound

The Bank of England recently raised the key interest rate by only 25 basis points to 4.25 %, although inflationary pressures remain high. The inflation rate remained above levels of 10 %. The British central bankers also do not give the impression of wanting to take clearer action against the high inflation rates. The choice of words sounds dovish. From the point of view of purchasing power, the British pound is blatantly undervalued against the US dollar, but with the cautious central banks this situation will not change for the time being. We therefore continue to expect a sideways movement of the British currency in a band between 1.15 and 1.25. In the coming weeks, a movement that could lead to the lower end of our forecast band is also conceivable. The British economy remains severely battered, also due to Brexit.

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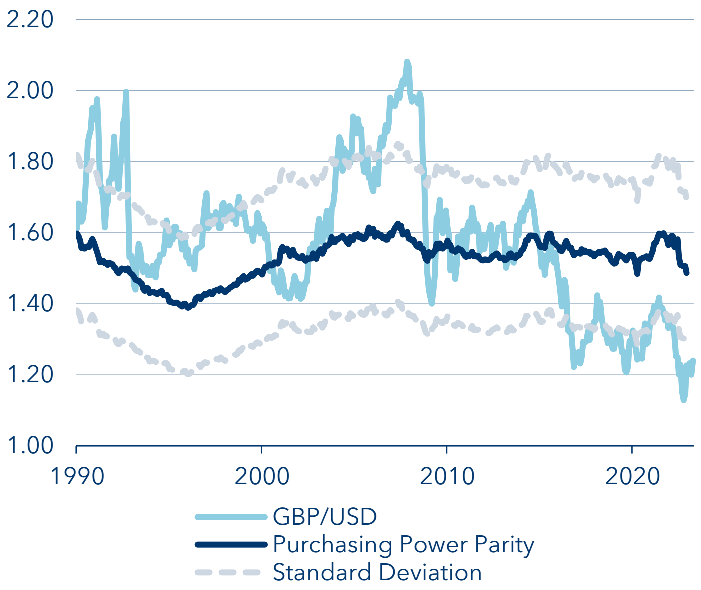

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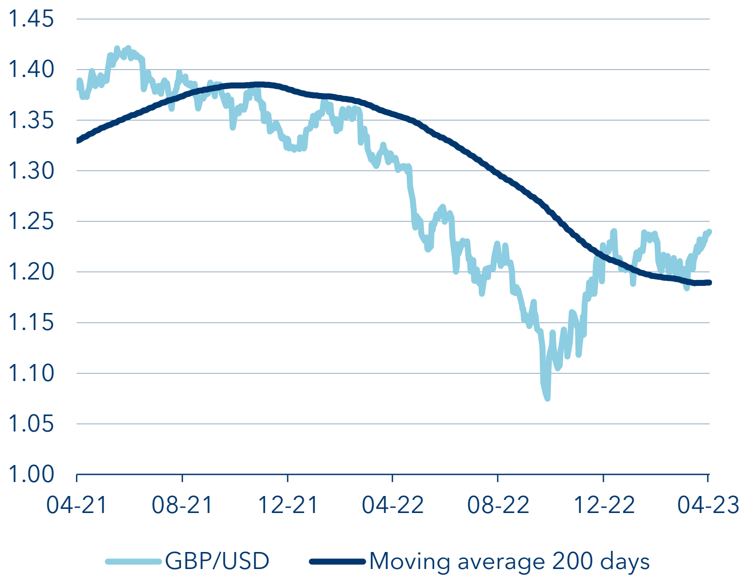

Our View on **EUR/SEK**

10.80 – 11.50
Expected range
for 3 to 6 months

- Swedish central bank tackles inflation with big interest rate hikes
- High current account surplus and healthy government finances counter SEK weakness

- If the ECB raises the key interest rate above the level expected by the money markets, the euro would appreciate even more significantly
- Currently still unfavourable environment for high-beta currencies like the SEK
- Economic risks in Sweden weigh on the krona

Swedish krona: Economic risks in focus

The appreciation of the krona that we had expected did not materialise. The currency markets are focusing more on the economic risks in Sweden. The mix currently consists of significantly lower property prices, rising insolvencies and increasing unemployment. At the same time, inflation is at a uncomfortably high level of 12%, which in principle is prompting the Swedish central bank to raise interest rates further. Given the increased economic risks, however, this is no easy undertaking. Although the Swedish central bank is committed to further interest rate hikes (the key interest rate is currently 3%), scepticism prevails on the currency markets. As the Swedish risks have come to the fore, we do not expect a rapid appreciation of the krona – despite the clear fundamental undervaluation.

Our View on **EUR/SEK**

10.80 – 11.50
Expected range
for 3 to 6 months

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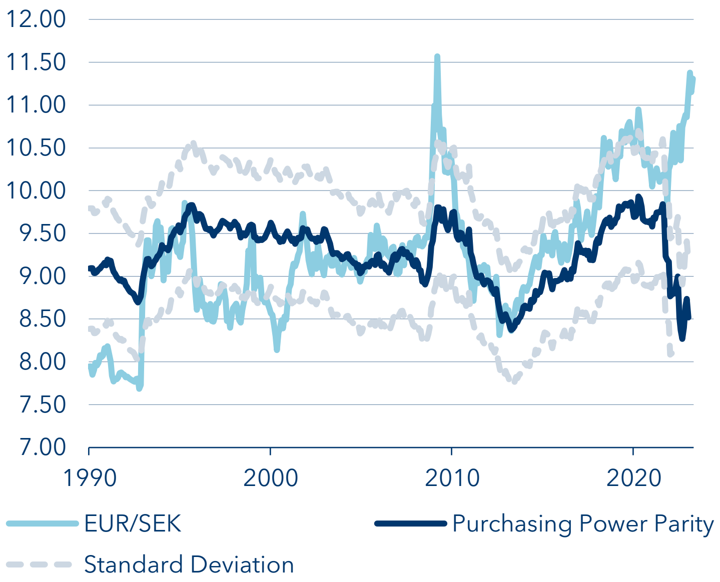

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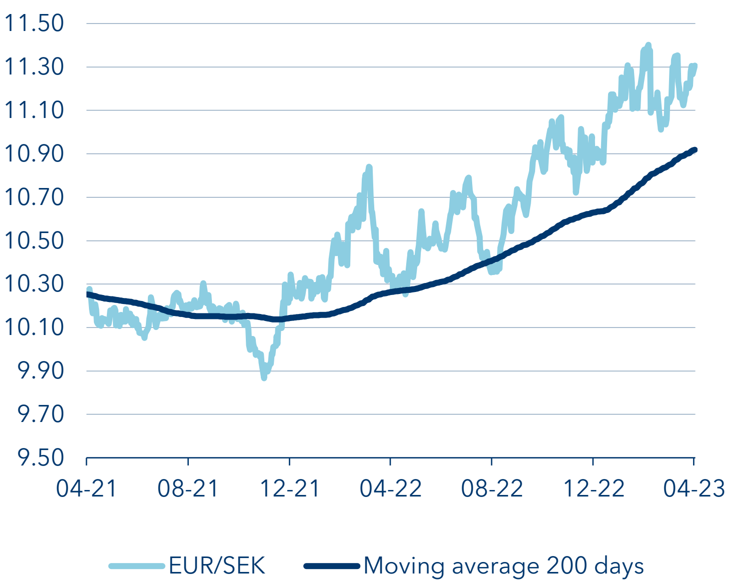

Authors and Disclaimer

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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.

Source: Bloomberg

Important legal advice