Our View on Currencies

Edition December 2023 and January 2024

VP BANK

New year, new start

Politically and economically, the coming year will be exciting. The US will elect a new president and the full negative economic consequences of the central banks' interest rate hikes are yet to materialise. The dollar is likely to remain well supported.

It is interesting to see, how things can change quickly: Until recently, there where a lot of whispers how high the central banks would go with interest rates, but now the situation changed. Markets are now focusing on interest rate cuts. This is reflected by money market´s expectations regarding the first interest rate cut and falling yields on long-term government bonds. Due to this circumstances the dollar has recently come under slight pressure. The broad dollar index fell by more than 3 %.

In our view, however, it would be premature to expect a sustained dollar weakness. The political and economic world will be shaken up in the coming year. Americans will elect a new president on 5 November. The historical pattern shows that in election years, the dollar gains significantly from the middle of the year onwards. Election polls then usually become precise: the uncertainty recedes and the greenback appreciates. With regard to the economy: While 2023 was still characterised by coronavirus catch-up effects, there will be no compensating effects in 2024.

Instead, the drastic increases in key interest rates will show their full negative economic impact. Therefore, there will be a lot of movement in the coming months - especially if the central banks actually start easing key interest rates. However, political and economic changes means uncertainty, which is good for the dollar in its function as a safe haven currency. We are largely sticking to our forecasts and do not expect any major bets on the currency markets in either direction.

Dr. Thomas Gitzel**, Chief Economist**

Our View on Currencies - Overview

Currency pairs

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Our View on **EUR/USD**

1.06 – 1.14
Expected range
for 3 to 6 months

- ECB has reached the interest rate high
- Speculative forward sales of the EUR have largely been unwound
- Monetary policy no longer supports the dollar
- The dollar remains in demand as a safe haven in uncertain times

- A weakening will of the ECB in the fight against high inflation rates could promote a renewed depreciation of the euro
- A dovish Fed could put pressure on the dollar

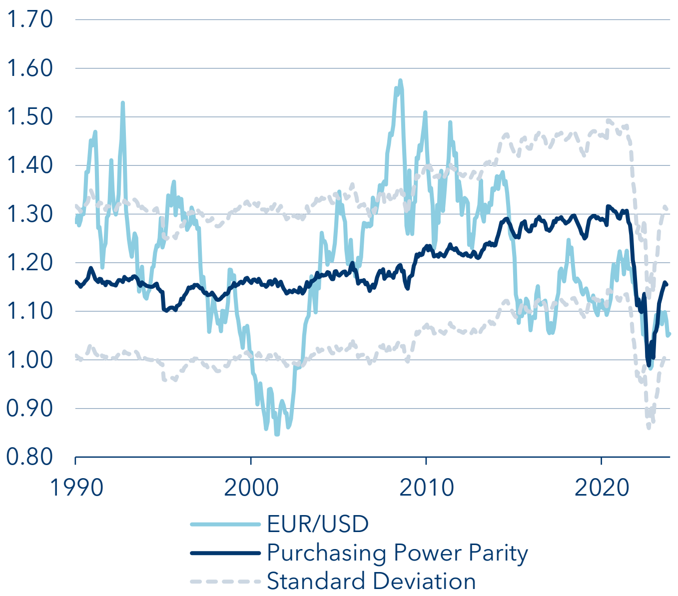
Dollar with weakening tendencies

The dollar has recently tended to weaken. Now that the Fed has signalled that it has reached its interest rate peak, the focus is on rate cuts. The first full cut is priced into the US money markets future curve for June. At the same time, the probability that the Fed will react as early as March is currently 30% according to the futures markets. Until recently, the probability of an interest rate cut in March was less than 15%. The adjusted expectation has been reflected in the recent depreciation of the dollar. At the same time, the EUR/USD pair broke through the 200-day line, meaning that the dollar should remain technically supported in the short term. For this reason, we are adjusting our forecast range upwards, but are leaving our fundamental assessment at "sideways". We do not expect a sustained depreciation of the dollar, as the ECB could also become increasingly dovish and thus weaken the euro on the other side.

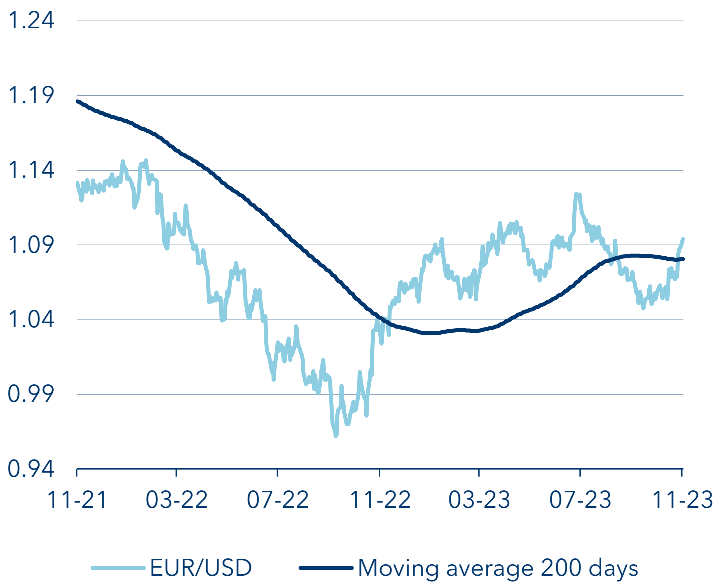
Our View on **EUR/USD**

1.06 – 1.14
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/CHF**

0.95 – 1.00
Expected range
for 3 to 6 months

- Euro loses monetary policy support
- SNB has reached its interest rate high
- The EUR/CHF currency pair is largely unaffected by monetary policy for the time being

- If the ECB were to implement interest rate cuts early, the euro would weaken significantly
- A sudden flight to safety would significantly weaken the euro against the franc

SNB supports the franc

The Swiss franc traded in a narrow band against the euro. There was simply a lack of impetus for major swings. Unless something extraordinary happens, both the ECB and the SNB have reached a peak in interest rates. Financial markets are already eyeing interest rate cuts. However, it will be some time before a reduction in key interest rates is actually on the agenda, meaning that monetary policy is unlikely to have any impact on the EUR/CHF currency pair for the time being. In the meantime, the Swiss National Bank (SNB) continues to reduce its foreign exchange reserves, thereby supporting the franc. This is precisely why we are sticking to our forecast trading range of between 0.95 and 1.00. The strength of the franc is likely to continue, and there are no signs of the euro appreciating. The ECB has more room for manoeuvre to cut interest rates, which is particularly damaging for the euro against the franc.

Our View on **EUR/CHF**

0.95 – 1.00
Expected range
for 3 to 6 months

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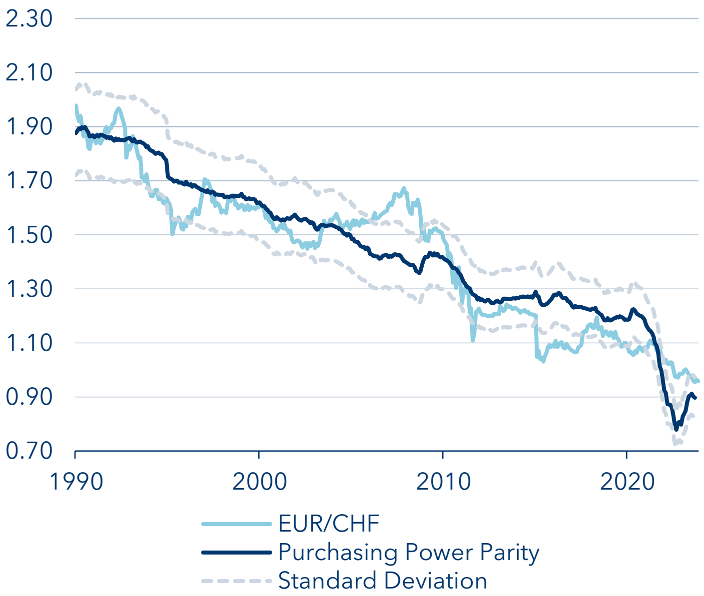

Technical view

Our View on **USD/CHF**

0.86 - 0.94
Expected range
for 3 to 6 months

- Both currencies are in demand in times of high uncertainty
- The dollar is losing monetary policy tailwind as the Fed has reached the end of its rate hike cycle

- If risk aversion sets in, the dollar would be ahead of the franc
- If the SNB were to hold out the prospect of interest rate cuts prematurely in view of low inflation rates, this could weaken the CHF

Expectations of interest rate cuts weigh on the USD

The Fed is increasingly gearing its monetary policy to actual data after the inflation models failed to predict the sharp rise in inflation rates. The currency markets are therefore acting cautiously. Large bets are not being made for the time being. The recession we were expecting is also still not on the table in the upcoming weeks. The players on the currency markets are probably feeling most comfortable on the sideline at the moment, which is why no major movements are expected on the USD/CHF currency pair. Should the economic slowdown in the US – which we expect - set in abruptly and the expectations of interest rate cuts become even more firmly established, the currency pair is likely to move towards the lower end of our forecast trading range. To put it more generally: US interest rate cut expectations are on the cards, so the dollar is not expected to strengthen immediately.

Our View on **USD/CHF**

0.86 – 0.94
Expected range
for 3 to 6 months

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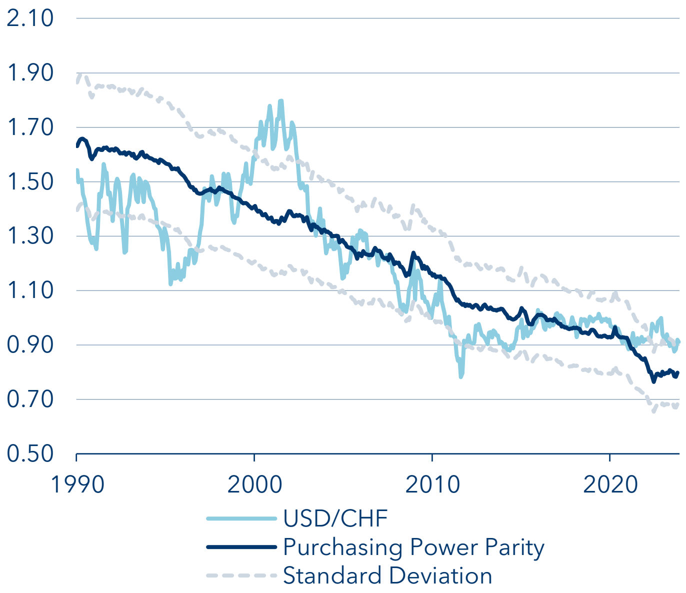
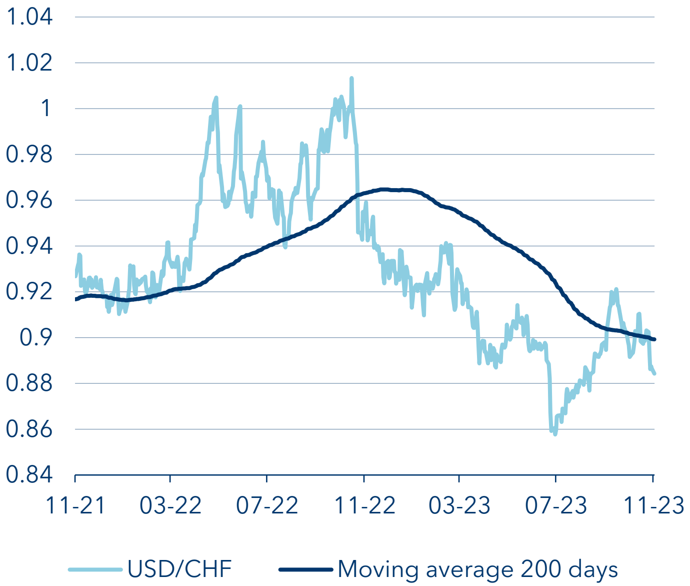


Technical view



Our View on **GBP/USD**

1.22 – 1.30
Expected range
for 3 to 6 months

- The pound is blatantly undervalued against the dollar
- On the dollar side, the Fed is done lifting interest rates

- Brexit is reducing the UK's potential growth, which argues against significant pound appreciation
- The pound remains fundamentally under pressure due to any weaker economic development in the UK

Inflation rates still high

The British economic engine is stuttering. Gross domestic product stagnated in the third quarter and the details looked dismal. Both private consumption and investments were in the red. As imports fell more sharply than exports, foreign trade provided a positive impetus for growth. This shows that the British economy is suffering more. It is precisely for this reason that the British central bank has changed its tone. There is no longer any talk of raising interest rates. At the same time, the inflation rate is still at a relatively high level with 4.6 %. If you exclude the volatile energy and food prices, it is still at a very high 5.7 %. In view of these inflation rates, there is some doubt as to whether the Bank of England will be successful in combating inflation in the long term. For this very reason, we do not expect the pound to appreciate more strongly.

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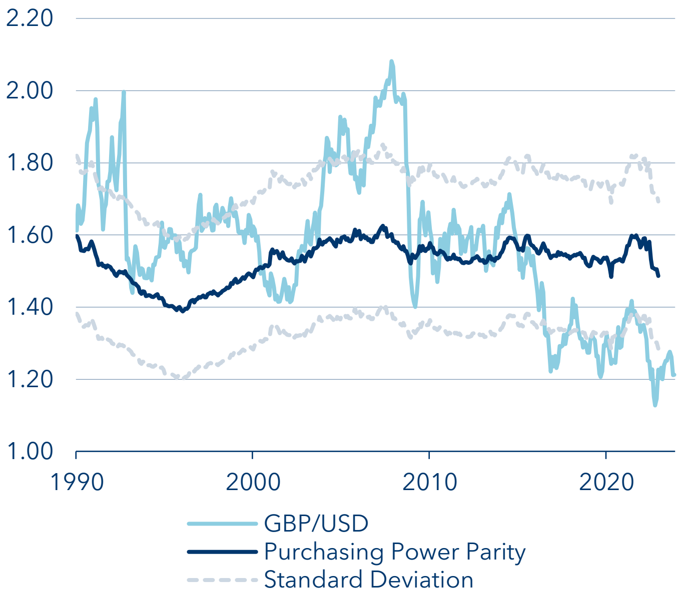

Technical view

Our View on **EUR/SEK**

10.80 – 11.50
Expected range
for 3 to 6 months

- A high current account surplus and healthy public finances counteract the weakness of the SEK
- A weakening of the ECB's resolve to combat the still high inflation would weaken the euro

- Currently still unfavourable environment for high-beta currencies such as the SEK
- In view of the still high inflation, the Swedish central bank is sounding increasingly cautious about further interest rate hikes, which could further weaken the SEK

Krona cannot benefit from undervaluation

Contrary to expectations, the Swedish central bank (Riksbank) kept its key interest rate constant at 4% in November. The Riksbank gave greater weight to economic risks. Although inflation rates have fallen noticeably, they still remain relatively high at 4.2%. The mix of high inflation, weak economic development and a simultaneously cautious central bank is likely to limit appreciation of the krona. In terms of purchasing power parity, the krona is significantly undervalued. But given the Riksbank's reluctance, this doesn't count at the moment. In any case, an appreciation of the Swedish krona can only be expected against the background of a sustained recovery of the global economy and a risk-friendly mood on financial markets. It will take some time before we will experience such an environment again. We therefore expect the relative weakness against the euro to continue for some time.

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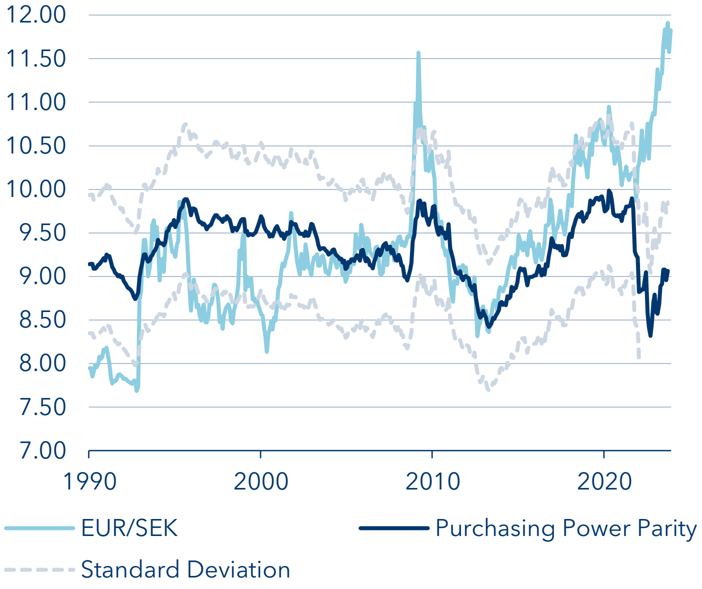

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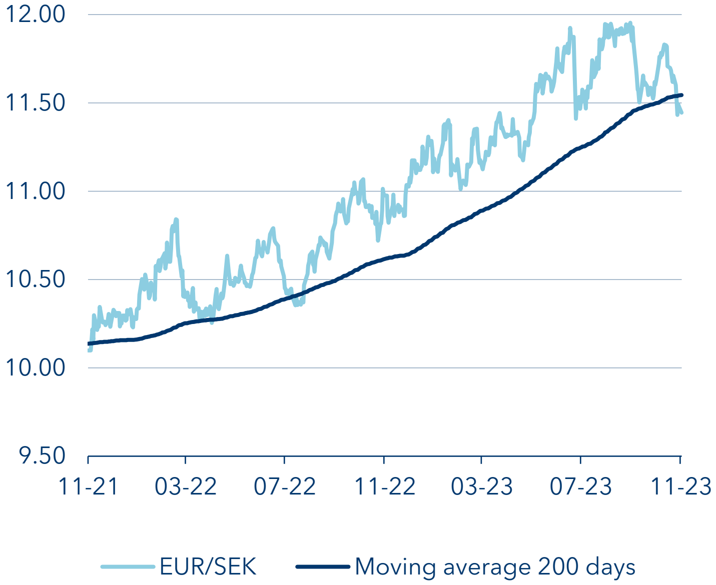

Authors and Disclaimer

Author:

Dr. Thomas Gitzel, Chief Economist

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