Our View on Currencies

Edition August and September 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

- ECB to maintain its rate hike cycle for a longer period of time
- Speculative forward sales of the euro are unwound
- Monetary policy no longer supports the dollar

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

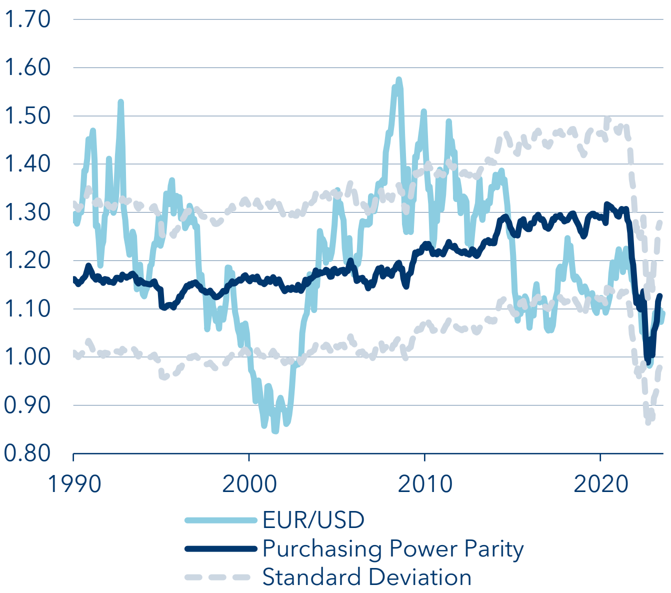
Dollar suffers bout of weakness

After the publication of the June inflation data in the USA, the dollar showed weakness. The inflation rate fell to 3 % in June and the core inflation rate also fell sharply to 4.7 %, which was unexpected. This means that the key interest rate is now significantly higher than the inflation rate and the Fed is now actually restrictive in this sense. Although the US monetary watchdogs raised the key interest rate again by 25 basis points in July, this is likely to have been the final interest rate step. This means that Fed interest rate fantasies are a thing of the past, which ultimately led to a bout of weakness in the greenback. Meanwhile, on the other side of the Atlantic, the ECB is likely to implement further interest rate steps. We therefore expect that the EUR/USD currency pair's flight upwards is not yet over and could lead to levels around 1.15.

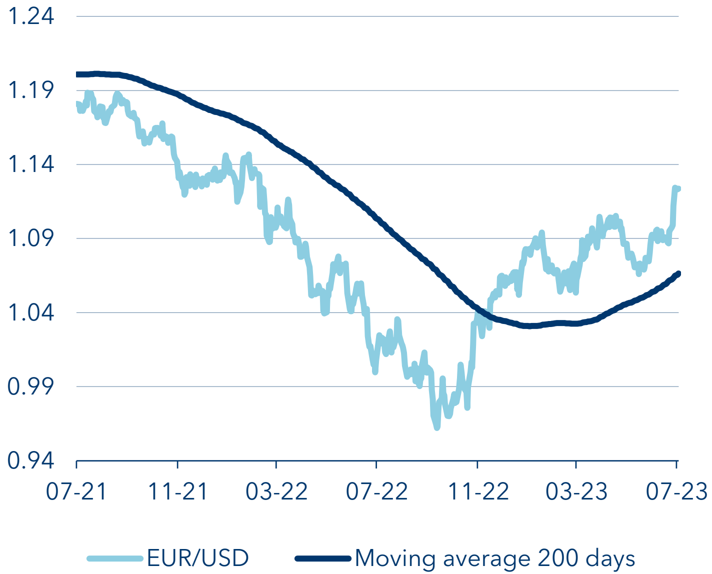
Our View on **EUR/USD**

1.07 – 1.15
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/CHF**

0.95 – 1.02
Expected range
for 3 to 6 months

- Euro benefits from ECB's continued monetary policy tightening
- The SNB could exercise restraint with regard to 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
- A sudden flight to safety would significantly weaken the euro against the franc

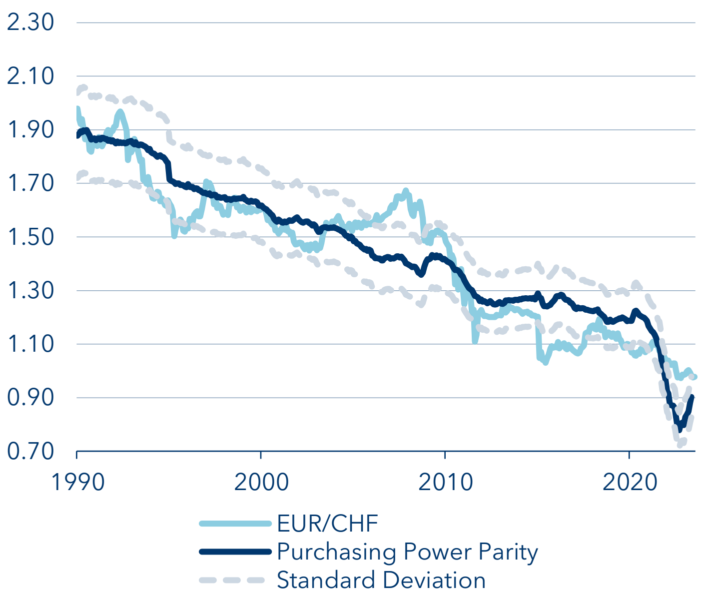
The franc remains a strong currency

While the EUR/USD currency pair have risen to higher levels, EUR/CHF held at low levels. This is unusual given the historical observable close correlation between the two currency pairs. Among other things, this is probably due to the SNB, which is strengthening the Swiss currency with its interventions in the foreign exchange market. For the export industry, the strong franc is not a disaster from a competitive point of view. The positive effects of lower inflation in international comparison more than compensate for the appreciation of the franc. This is made visible by means of the trade-weighted effective real exchange rate of the franc. Thus, if one looks at the franc vis-à-vis the most important trading partners, taking into account the inflation differential, a depreciation of the Swiss currency can even be observed. This is precisely why the SNB can continue to intervene. The franc will remain a strong currency.

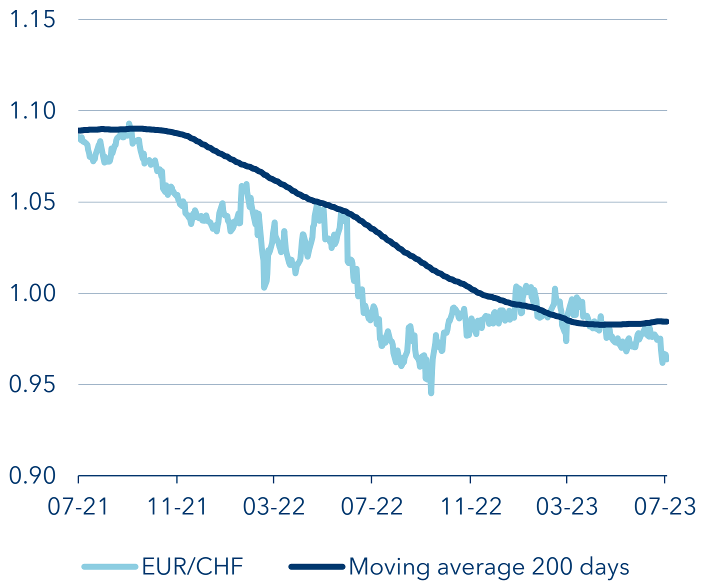
Our View on **EUR/CHF**

0.95 – 1.02
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **USD/CHF**

0.84 – 0.90
Expected range
for 3 to 6 months

- Both currencies are in demand in times of high uncertainty
- Dollar loses monetary tailwind as Fed reaches its rate hike cycle in our view

- In the event of high risk aversion setting in, the dollar would have the edge over the franc
- If the SNB were to prematurely declare its rate hikes over, this could weaken the CHF

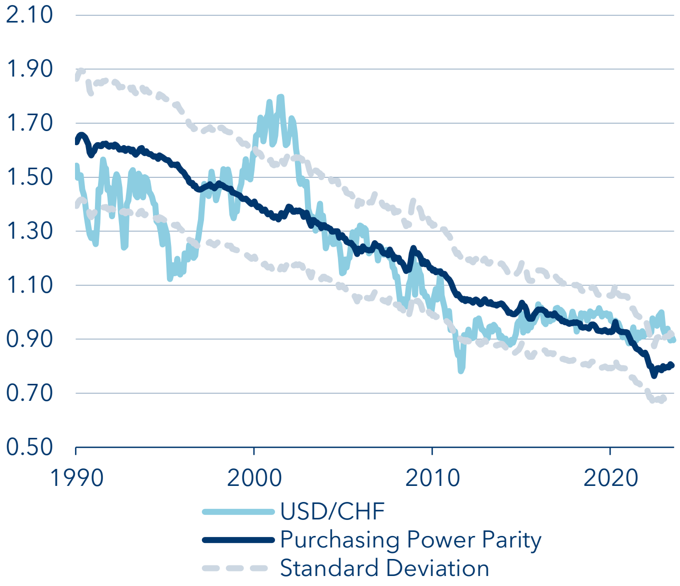
Weakness of the dollar led to lower levels of USD/CHF

The general weakness of the dollar was also reflected against the franc. The low levels of the USD/CHF currency pair are justifiable from a fundamental perspective. From a purchasing power parity perspective, the franc is favourably valued and still has potential for further gains. The US inflation rates will fall in the autumn further and than also economic weakness should become more apparent. We therefore believe that the Swiss franc will make further gains against the US dollar, although these are unlikely to be significant. It should not be forgotten that the greenback is also in demand as a safe haven in times of high economic uncertainty. So the more clearly the blistering effects of the significant interest rate hikes by the major central banks become apparent, the more the greenback could also benefit again. For this reason, we are looking to a larger sideways movement between 0.84 and 0.90.

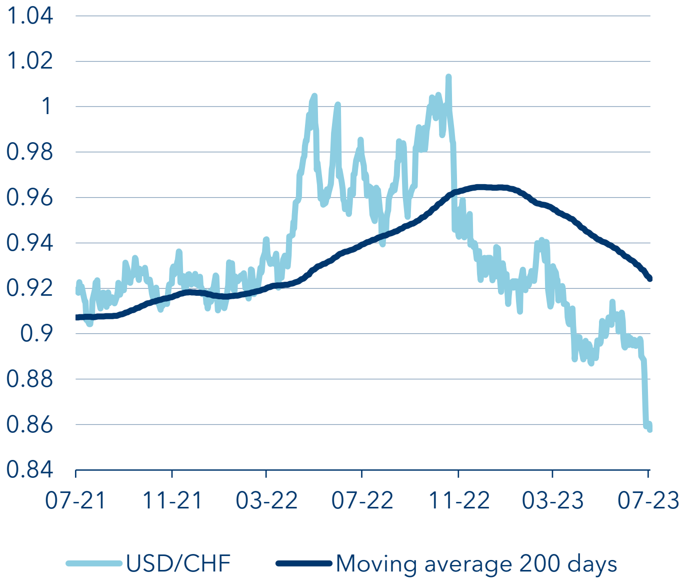
Our View on **USD/CHF**

0.84 – 0.90
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **GBP/USD**

1.25 – 1.40
Expected range
for 3 to 6 months

- The pound is blatantly undervalued against the dollar
- On the dollar side, the Fed's rate hike path is largely priced in

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

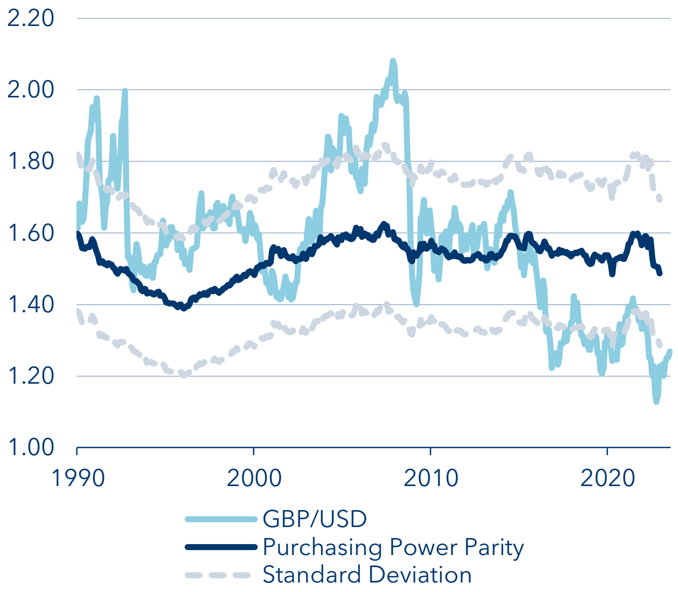
Pound benefits from higher interest rates

As we expected, the pound was able to gain some ground against the dollar. However, this is not an explicit strength of the pound but rather a weakness of the dollar. In view of high inflation rates of still over 8%, further interest rate hikes by the Bank of England still seem likely. This will close the nominal interest rate gap with the US, which could help the pound. Since, in our view, the Fed is at the end of its rate hikes and the Bank of England could be forced to raise rates even further, there is still some upside potential for the British currency. We are therefore raising our price target and expect that the pound could push up to the 1.40 range. However, this will probably not be a straight-line movement. Short-term setbacks cannot be ruled out over the next 6 months, which is why we are widening our forecast range.

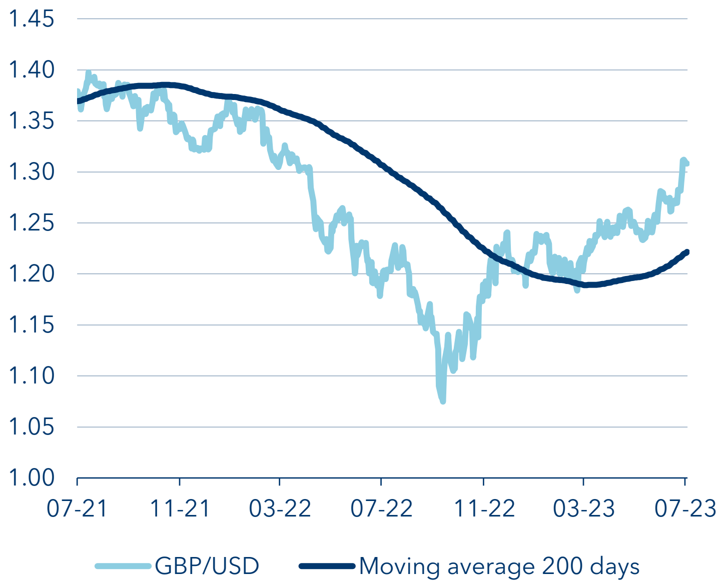
Our View on **GBP/USD**

1.25 – 1.40
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/SEK**

10.80 – 11.50
Expected range
for 3 to 6 months

- High current account surplus and healthy public finances counter SEK weakness
- A weakening will of the ECB in the fight against still high inflation would weaken the euro

- 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
- The Swedish central bank sounds increasingly cautious about further interest rate hikes in view of still high inflation

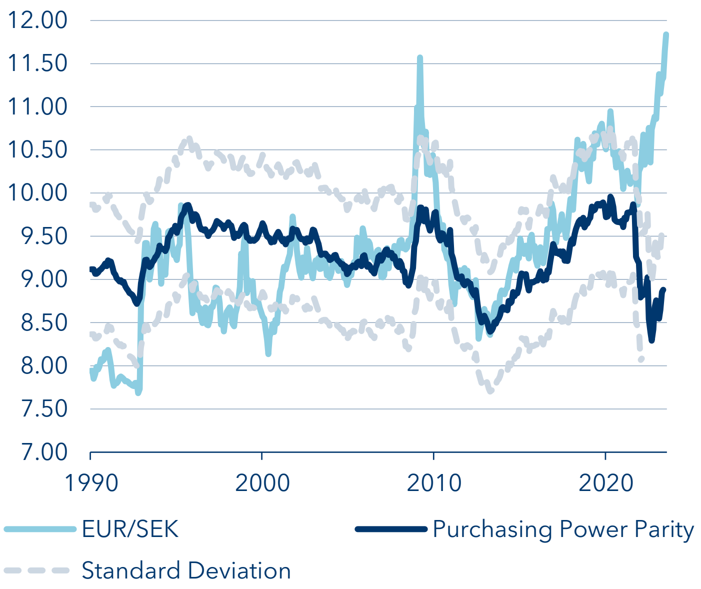
Krone can not benefit from undervaluation

It is currently not the right environment for price gains for the Swedish krona. By its nature, the SEK is a high-beta currency that benefits from a benign stock market environment, low risk aversion and, above all, an environment of global economic upswing. The Corona pandemic, the high geopolitical uncertainties associated with the Ukraine war, together with a global economic environment tending towards recession, have been weighing on the SEK for some time. We do not expect a change of direction in the currency's development in the short term. A quick end to the war in Ukraine cannot be expected at present, and the global economic environment will remain difficult this year. The krona is therefore likely to remain at its historically weak level against the euro for some time – despite the blatant undervaluation in terms of purchasing power parity (see chart on next week).

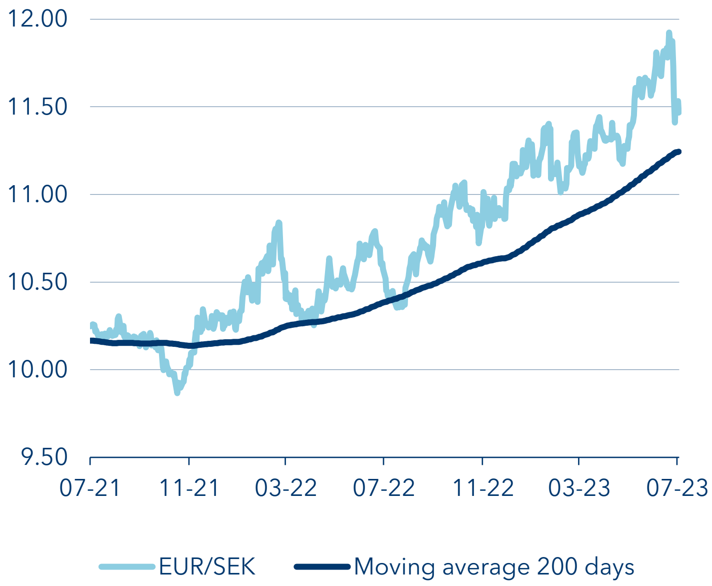
Our View on **EUR/SEK**

10.80 – 11.50
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



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