Our View on Currencies

Edition December 2022 and January 2023

VP BANK

Our View on Currencies - Overview

Currency pairs

Our View on **EUR/USD**

1.02 – 1.10
Expected range
for 3 to 6 months

- The high US twin deficit is a burden for the USD
- High speculative forward sales signal a stronger euro
- The surprise potential lies on the ECB's side and thus on the side of the euro

- The euro is still undervalued in terms of purchasing power parity
- Fed is close to interest rate peak High dependence on expensive energy imports is a burden for the euro

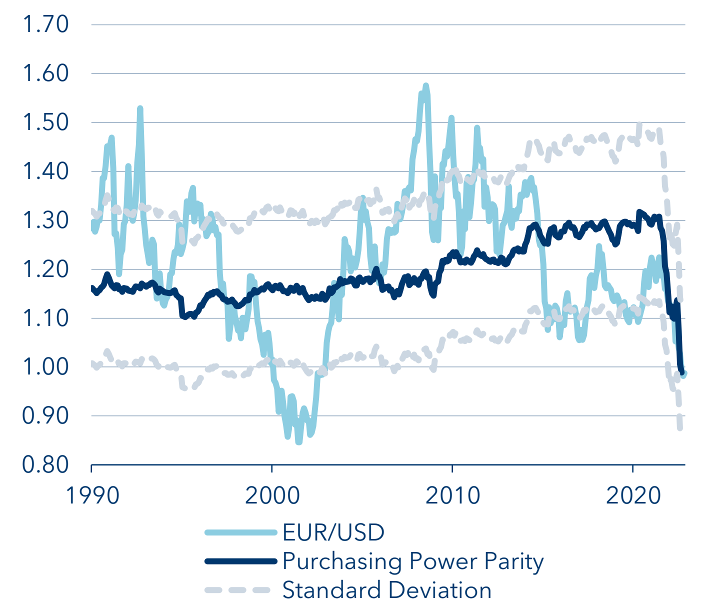
US dollar: It is not all about strength

For once in a long while, the U.S. dollar showed at least some weakness. There are many reasons for this. On the one hand, there are signs that the US Federal Reserve will probably refrain from further interest rate hikes in the near future. On the other hand, the recent increase in risk appetite on the financial markets is certainly also playing a role. The need for safe havens has decreased. In turn, government measures to cap energy prices in Europe are also supporting the euro. A gas shortage has also become less likely. Concerns about a severe crash of the European economy are thus diminishing. The purchasing power parity valuation is blowing the same horn, according to which the euro still has room for gains. This could be supported by market technical factors, especially if EUR/USD breaks through the 200-day line. We are therefore adjusting our target range and now expect rates between 1.02 and 1.10 in the coming three to six months.

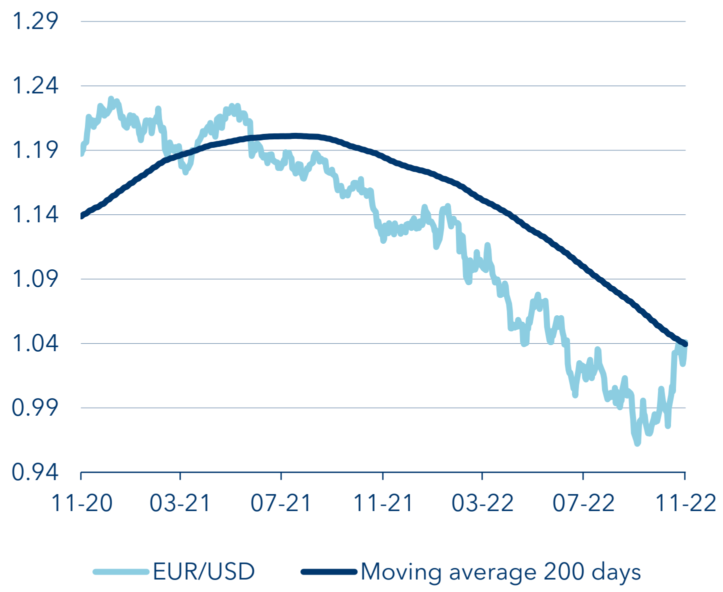
Our View on **EUR/USD**

1.02 – 1.10
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

- SNB commits to further interest rate hikes
- Despite the appreciation of the Swiss franc, Switzerland is not losing competitiveness due to the moderate inflation trend

- If the ECB launches an aggressive monetary policy turnaround in the coming months, this would argue for a stronger EUR
- If the EUR gains against the USD, this will also result in a higher EUR/CHF exchange rate

Swiss franc: EUR/USD development also plays a role

While the inflation rate in the euro zone is over 10%, the inflation rate in Switzerland has actually declined slightly (most recently: 3%). The glaring inflation differential supports the Swiss franc from a purchasing power parity perspective. If the SNB sticks to further interest rate hikes, it will also ensure positive real yields faster than the ECB, which would also benefit the Swiss currency. However, if our assessment of a stronger euro against the U.S. dollar proves correct in the coming months, the EUR/CHF currency pair would not be able to completely decouple itself from this movement. However, we do not expect a significant weakening of the franc, as the SNB has confirmed that it would consider selling foreign currencies should the franc depreciate. After all, a strong franc helps the SNB to keep inflation risks in check.

Our View on **EUR/CHF**

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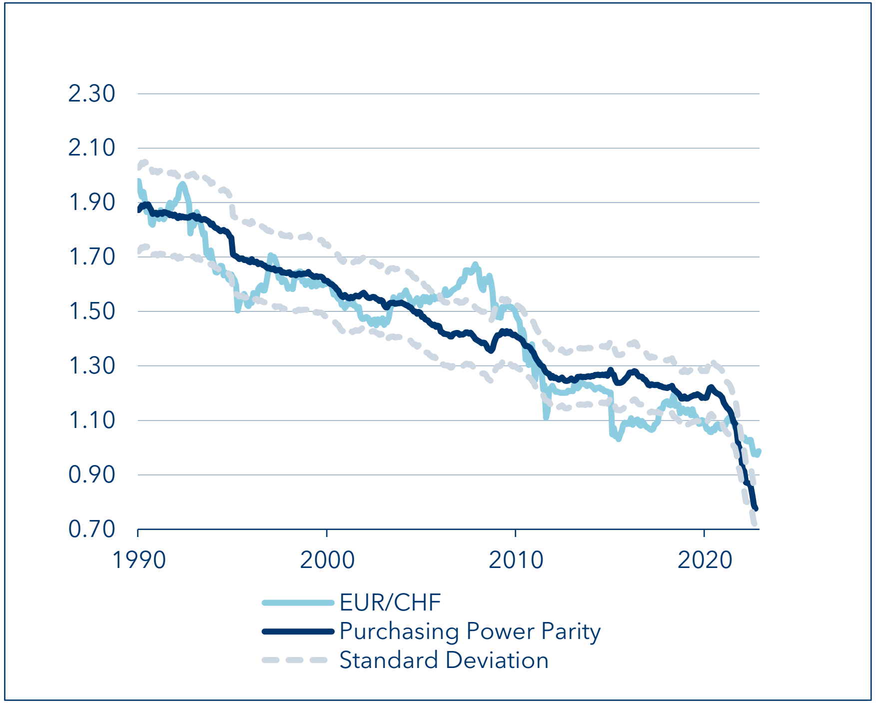
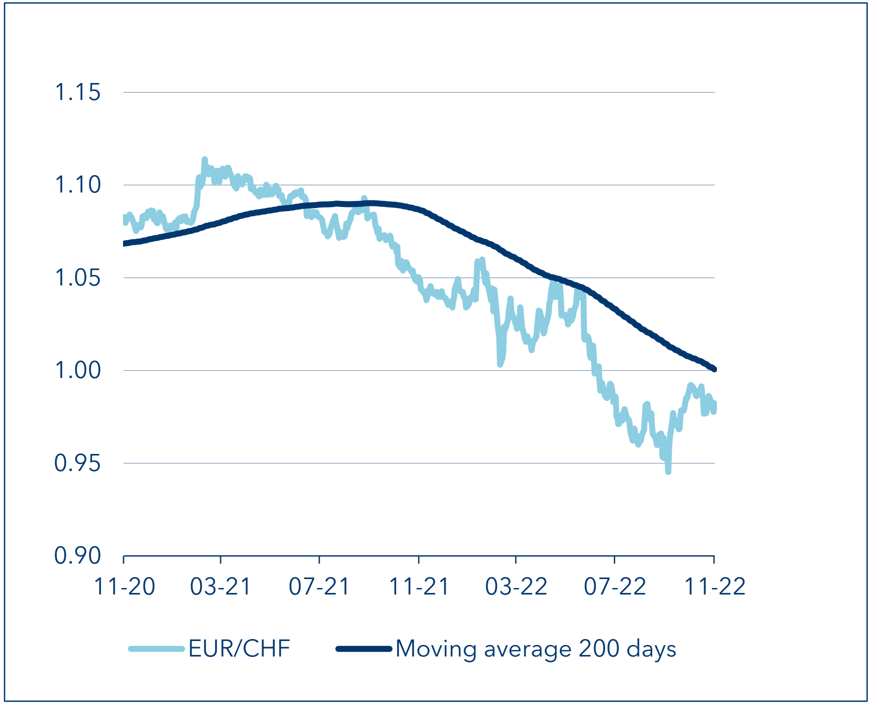


Technical view



Our View on **USD/CHF**

0.90 – 0.98
Expected range
for 3 to 6 months

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

- The Fed will have reached the interim interest rate high shortly
- The high US twin deficit is a burden for the US dollar

US dollar: Further weakness expected against the CHF

The franc took the direction we expected and appreciated against the US dollar. If the US inflation rate falls more in the coming months, the Fed could refrain from further interest rate hikes in the near future. If, at the same time, the risks of recession increase, the financial markets would probably look for more interest rate cuts by the Fed. In this case, the greenback will probably tend to weaken further and the USD/CHF currency pair would open up a path toward the 0.90 level. From a purchasing power parity perspective, the franc would by no means be overvalued. The fair levels we have calculated are below 0.90. Against this backdrop, we are adjusting our forecast range and extending it downward. We therefore believe that the franc can still make further gains against the US dollar.

Our View on **USD/CHF**

0.90 – 0.98
Expected range
for 3 to 6 months

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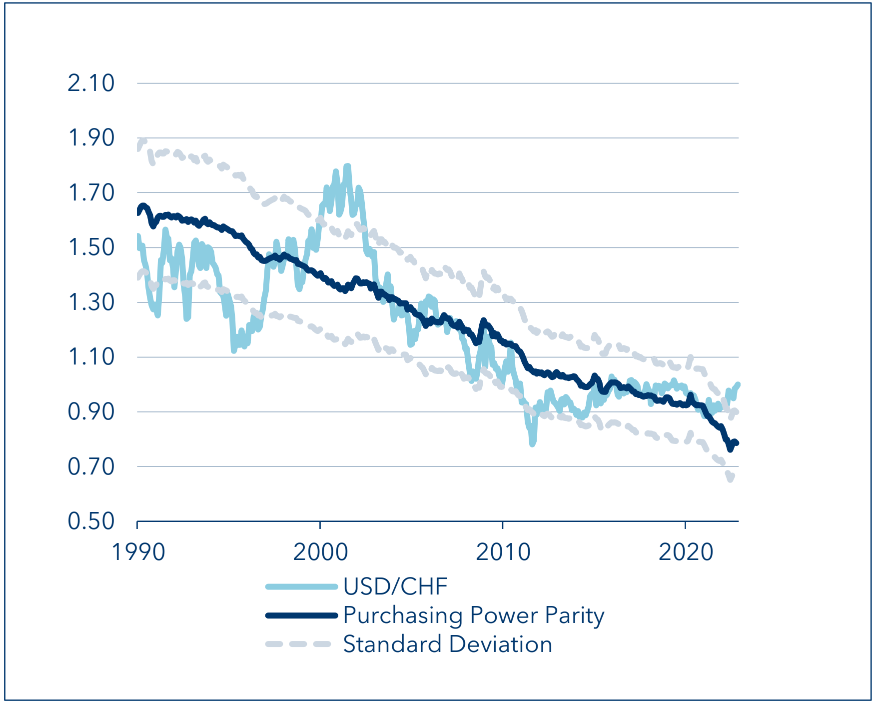

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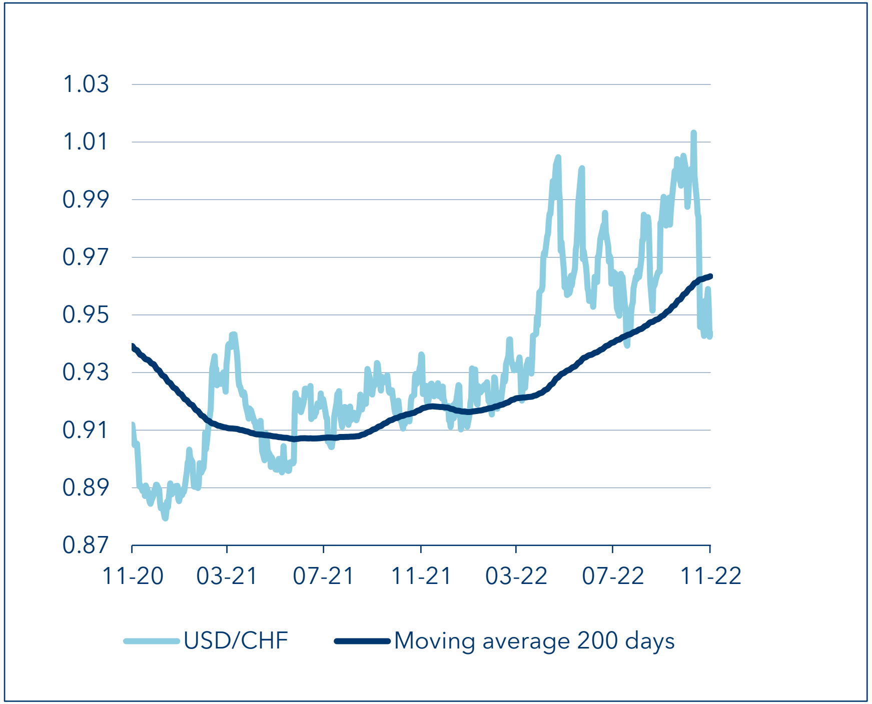

Our View on **GBP/USD**

1.15 – 1.25
Expected range
for 3 to 6 months

- The pound 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 significant pound appreciation
- Pound Sterling remains under pressure due to possible weaker economic development in the UK

Pound: Limited recovery potential

The recent upward movement in the GBP/USD currency pair is primarily based on the general (moderate) dollar weakness. Slight support certainly also came from the side of the Kingdom. The new prime minister, Rishi Sunak, managed to regain the tarnished confidence. Meanwhile, the British central bank remains cautious. The Bank of England recently emphasized recession risks, which does not suggest that an aggressive monetary tightening cycle is now on the agenda. As long as the Bank of England does not react more clearly to the very high inflation rates, we do not see a recovery of the pound, despite the obvious undervaluation. This view is also supported by the blatant economic consequential damages of the Brexit.

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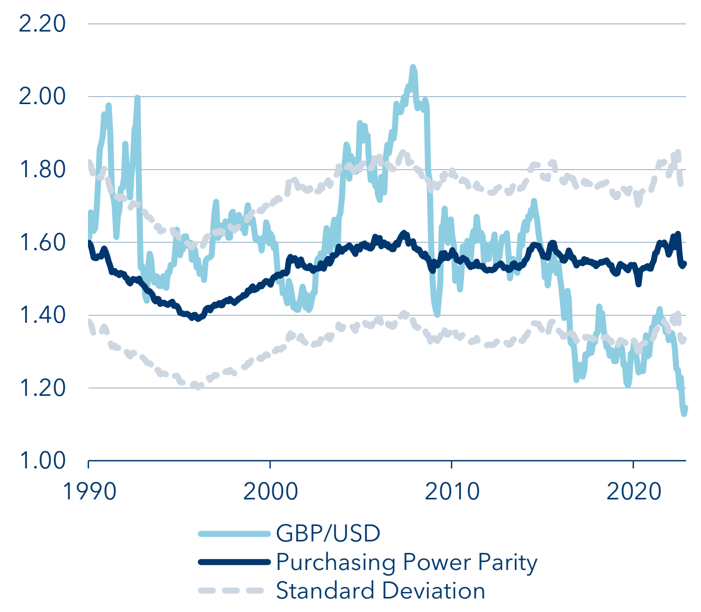

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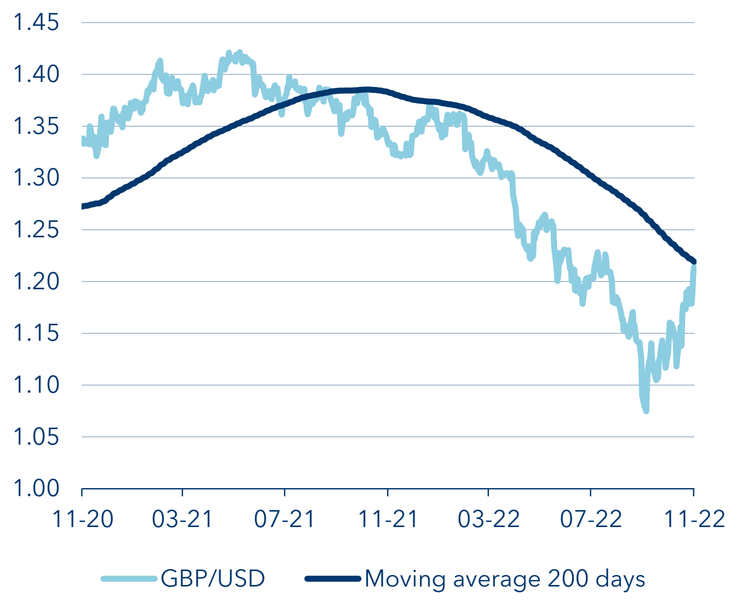

Our View on **EUR/SEK**

10.00 – 11.00
Expected range
for 3 to 6 months

- Swedish central bank tackles inflation with very large interest rate hikes
- Robust growth to date, a high current account surplus and healthy public finances counter the weakness of the SEK

- 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 unfavorable environment for high-beta currencies like the SEK
- A favorable outlook for the global economy is needed for sustained appreciation of the SEK

Swedish krona: Interest rate hikes do not help

The euro is prominently measured against the U.S. dollar. In view of this, it is almost lost sight of the fact that the European common currency is also a "safe haven" due to the large currency area and liquid trading. This is impressively demonstrated against the Swedish krona. The Scandinavian currency could not benefit even from the hawkish tones and energetic action of the Swedish central bank (Riksbank). At its monetary policy meetings, the Riksbank recently raised the key interest rate twice in a row by 100 basis points each time (key interest rate: 2.5%). This means that the key rate level exceeds that of the ECB, without any significant appreciation of the krona as a result. In our view, the SEK is only likely to appreciate more significantly again in the environment of a sustained recovery of the global economy. As this is not in sight for the time being, we are sticking to our forecast range, which has been valid for some time now

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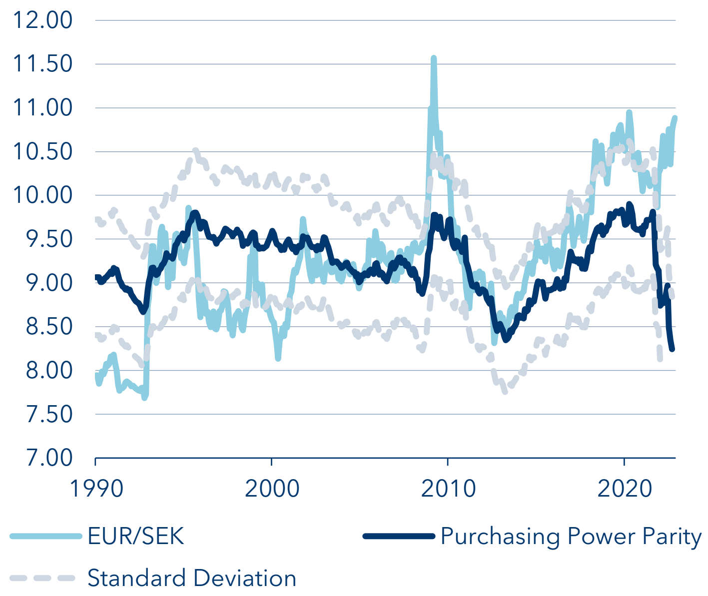

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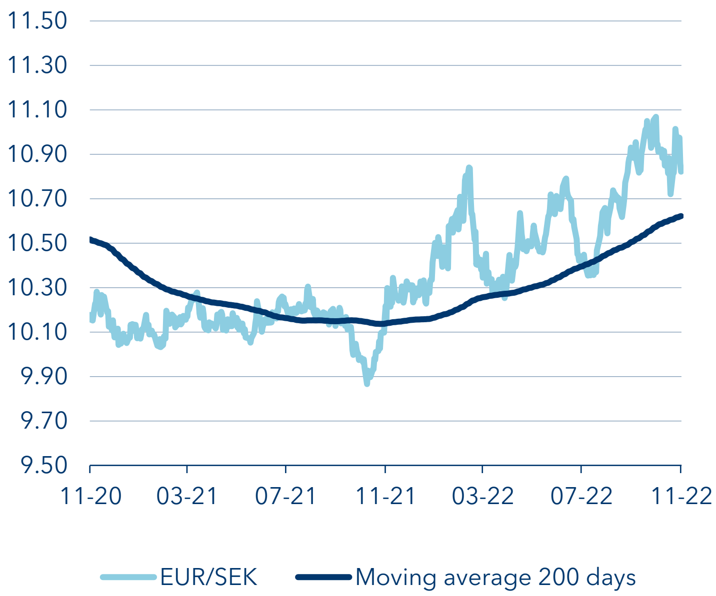

Authors and Disclaimer

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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