# **Our View** on Currencies

Edition February and March 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 cycle of interest rate hikes for a longer period of time
- Speculative forward sales of the euro are being unwound

- If the Fed continues to hike rates for a longer period of time, the dollar could regain ground
- Newly emerging risk aversion would be in favour of the dollar
- A weakening of the ECB's will in the fight against high inflation rates could stand in the way of a further euro recovery

### The euro had a good run recently

The economic outlook for the eurozone brightened recently. The much-feared energy crisis has become unlikely this winter. At the same time, the European Central Bank (ECB) is committed to further interest rate hikes. For this very reason, the positive euro trend of recent weeks could continue for some time. Market factors also play a role in this. Last year, speculative investors bet on a continued weakness of the euro by selling futures. As data show, these bets are now being unwound. To do so, euros have to be bought on the spot market, which consequently leads to price gains for the common currency. Meanwhile, on the other side of the Atlantic, the US Federal Reserve is nearing the end of its monetary tightening cycle. The influence of interest rate hike fantasies on the dollar exchange rate is fading. The current tailwind could carry the euro into the 1.15 range.

# Our View on **EUR/USD**

**1.07 – 1.15**
Expected range
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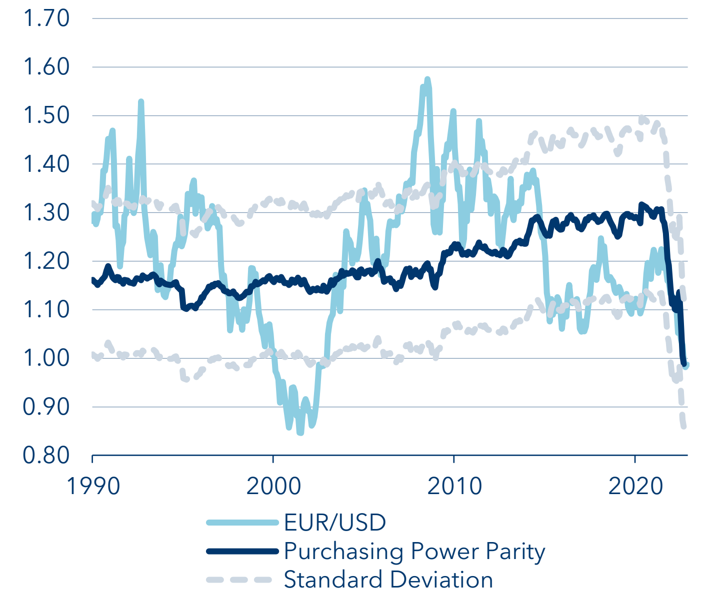
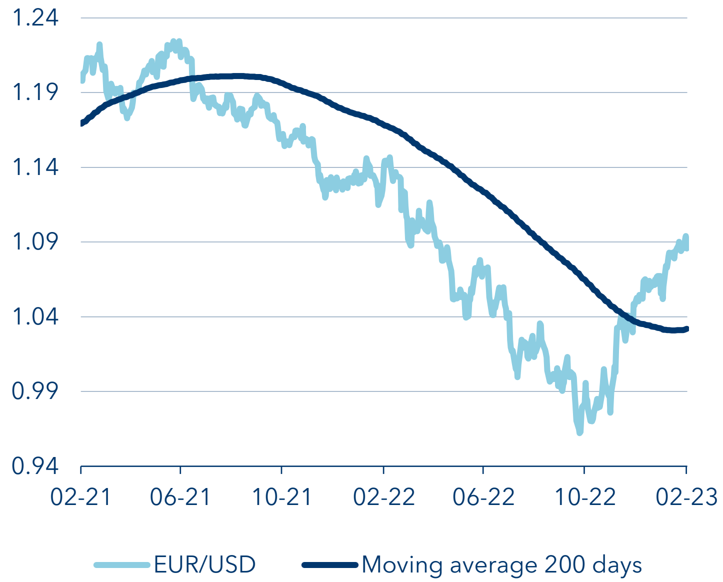
## Purchasing power parity (producer prices; monthly data)




## Technical view



# Our View on **EUR/CHF**

**0.98 – 1.04**
Expected range
for 3 to 6 months

- The euro is benefitting from the ECB's continued monetary policy tightening
- The SNB could exercise restraint with regard to further interest rate hikes which weighs 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 growth slump in the euro area, this would have negative consequences for the euro

## Euro gains also against the Swiss franc

The Swiss franc is still favourably valued against the euro due to the glaring inflation differential between the two currency areas. Although, the influence of the EUR/USD pair on the exchange rate of the euro against the Swiss franc should not be underestimated. If the euro gains against the greenback, the EUR/CHF cannot decouple. Since we believe that the euro will continue to strengthen, the EUR/CHF currency pair will also trend somewhat higher. In the process, exchange rate levels of 1.04 could come into view. The euro is also getting support from the ECB, which will continue to tighten monetary policy for the time being. The Swiss National Bank (SNB) will be more cautious relative to the ECB, which will widen the nominal interest rate differential between the two currency areas - in favour of the euro.

# Our View on **EUR/CHF**

**0.98 – 1.04**
Expected range
for 3 to 6 months

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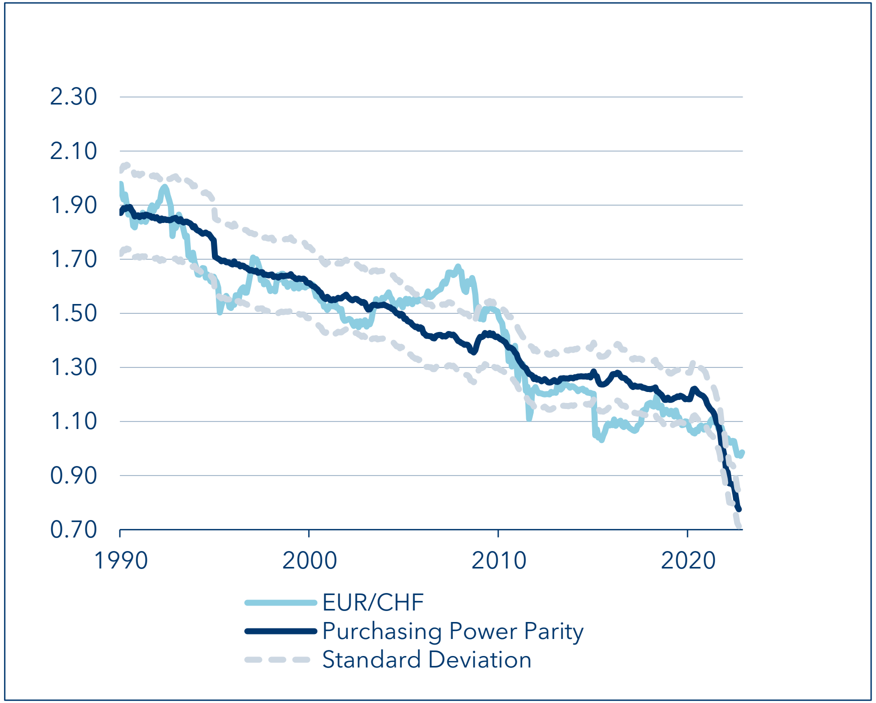


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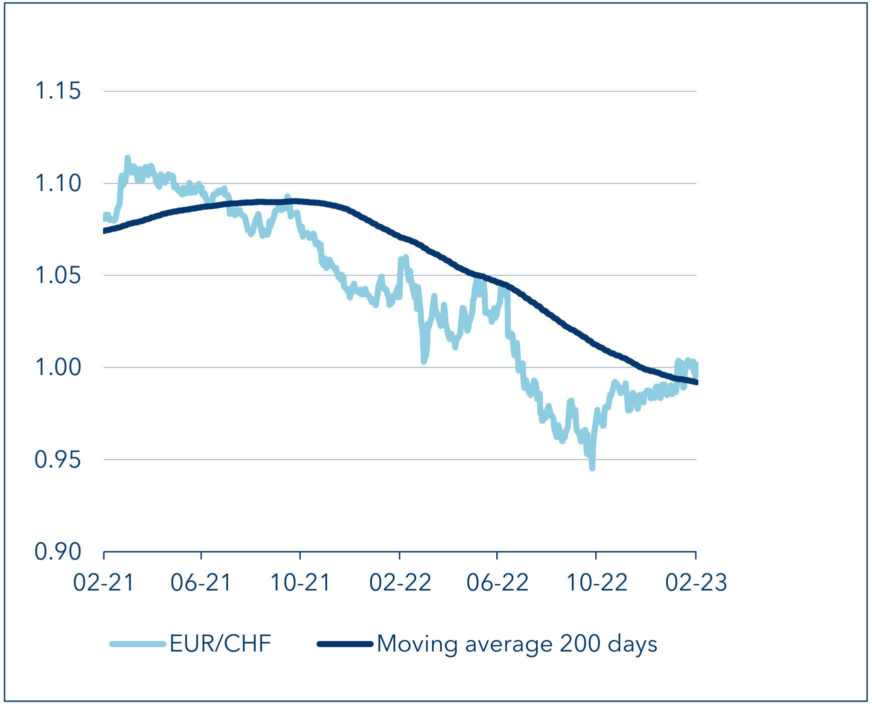

# Our View on **USD/CHF**

**0.90 – 0.98**
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

- The Fed will have reached its interim interest rate high soon
- High US twin deficits are a burden for the dollar

## US dollar: Further weakness expected against the CHF

The dollar's muscle is weakening. On the one hand, the Fed is heading for the end of its interest rate hike cycle. For another, the dangers of recession are currently even more obvious in the USA than in Europe. And from a purchasing power parity perspective, the Swiss franc is favourably valued anyway and still has potential for further gains against the dollar. The further US inflation rates fall in the coming months and the clearer an economic weakness becomes, the more the dollar should weaken. We therefore expect the Swiss franc to make further gains against the US dollar. In the process, the 0.90 mark could come into view in the next 3 to 6 months.

# Our View on **USD/CHF**

**0.90 – 0.98**
Expected range
for 3 to 6 months

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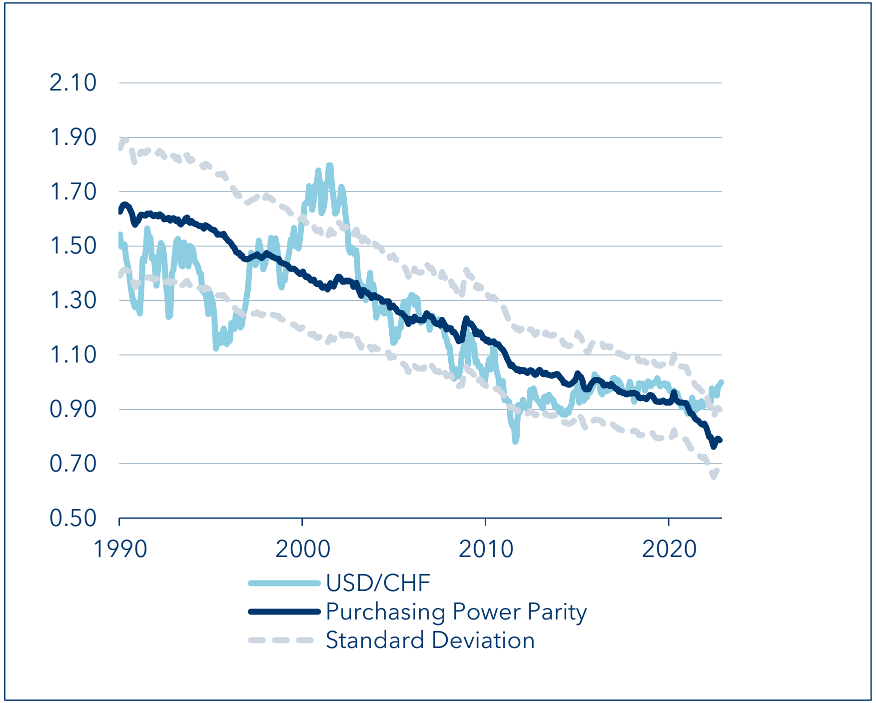


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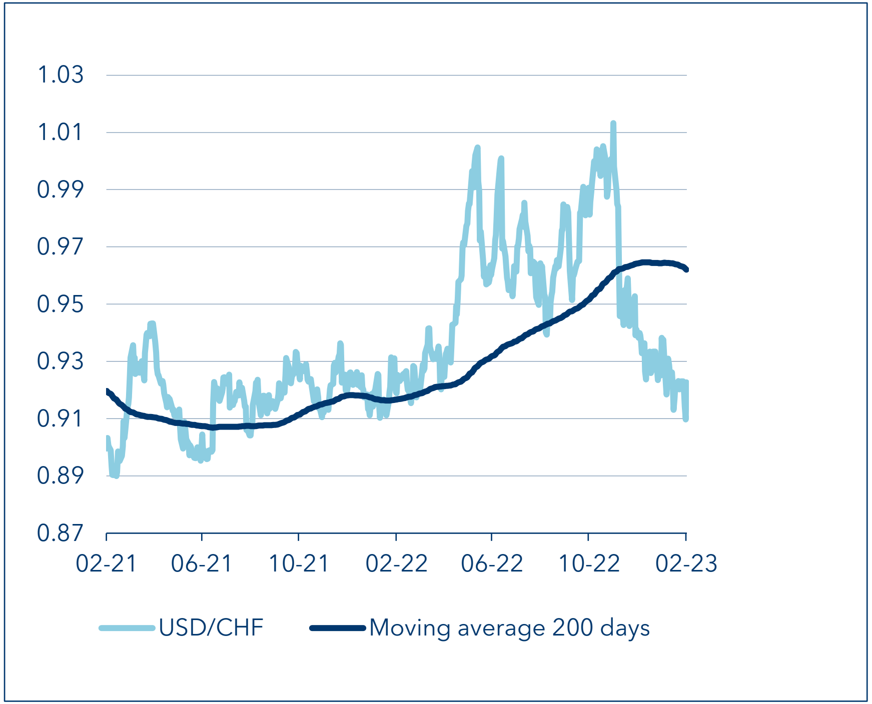

# Our View on **GBP/USD**

**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 a significant appreciation of the pound
- Sterling remains fundamentally depressed due to possible weaker economic development in the UK

## Pound: Limited recovery potential

Inflation rates in the UK are still at elevated levels, reducing purchasing power and leading to large-scale public sector strikes. The loss of purchasing power manifests itself in a sharp decline of retail sales. But industrial production has also been falling for some time now. Behind all these developments, the consequences of Brexit are becoming obvious. The decoupling from mainland Europe is a burden for the British economy. The Brexit reduces welfare. Meanwhile, the pound was recently able to gain against the dollar, although this is not due to the strength of the British currency but rather to a weakness in the greenback. While we attribute little strength to the pound for fundamental reasons, we have to admit that the market technical picture supports further gains for the British currency. The dollar weakness could therefore continue and open the way towards levels of 1.25.

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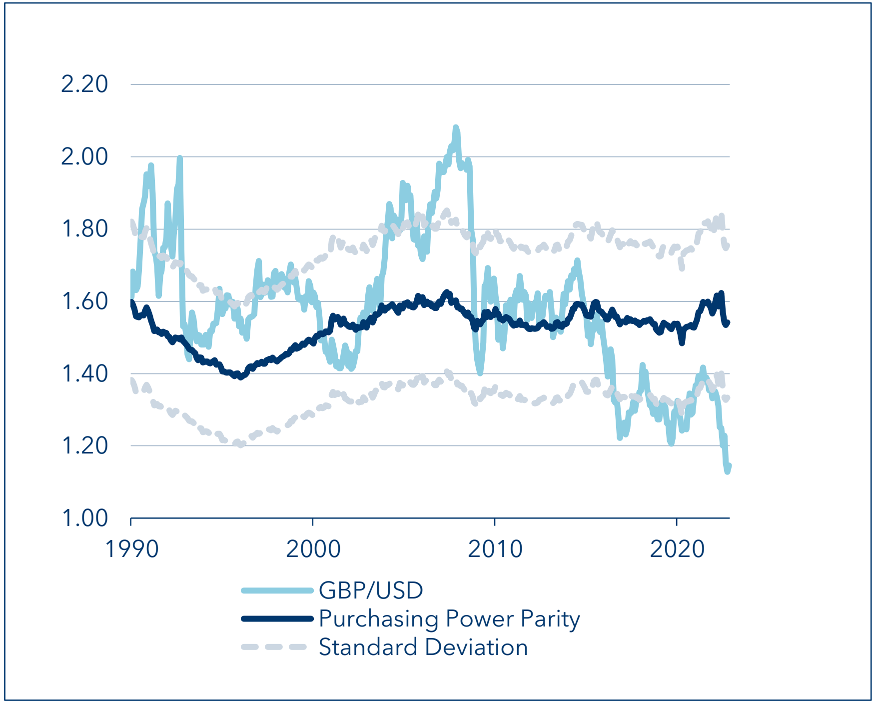


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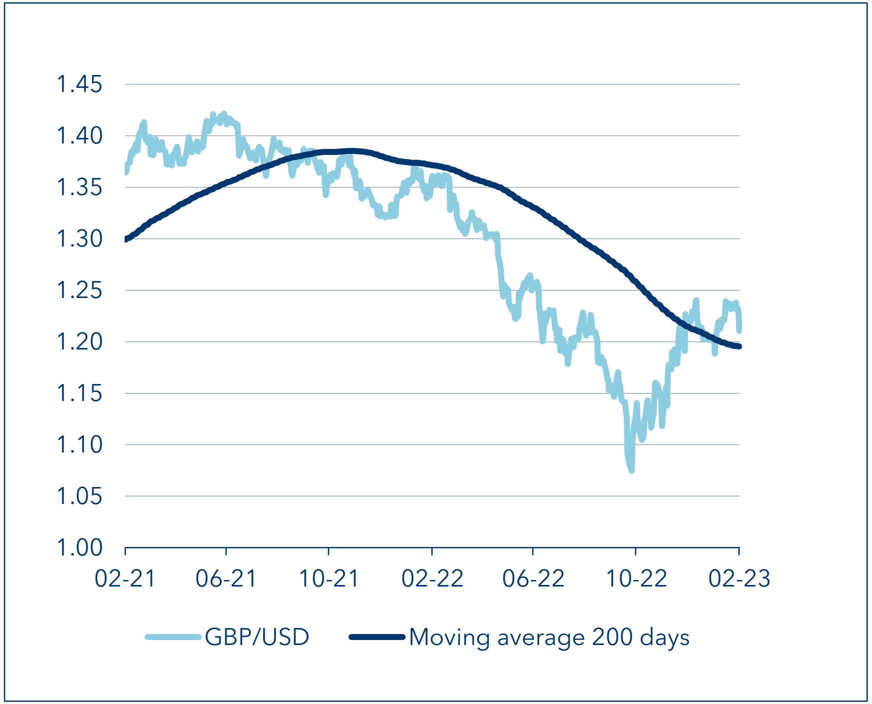

# Our View on **EUR/SEK**

**10.00 – 11.00**
Expected range
for 3 to 6 months

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

- If the ECB raises the key interest rate above the level expected by the markets, the euro would appreciate even more significantly
- Currently still unfavourable environment for high-beta currencies like the SEK
- A favourable outlook for the global economy is needed for sustained appreciation of the SEK

## Swedish krona: Interest rate hikes do not help

We were surprised by the recent bout of weakness in the Swedish currency. Above all, the further significant increase in the inflation rate had a negative impact on the currency. The market does not trust the Swedish central bank (Riksbank) to be tough enough in the fight against high inflation rates, which is why the currency was punished. The Riksbank must now show resolve, or the currency weakness could continue. However, we are convinced that the Swedish monetary policy makers will send clear signals. This is precisely why we expect the Swedish krona to recover somewhat against the euro in the coming months. We see the SEK returning to a level below 11 against the euro. However, a sustained and significant appreciation of the krona can only be expected when the global economy returns to a recovery path.

# Our View on **EUR/SEK**

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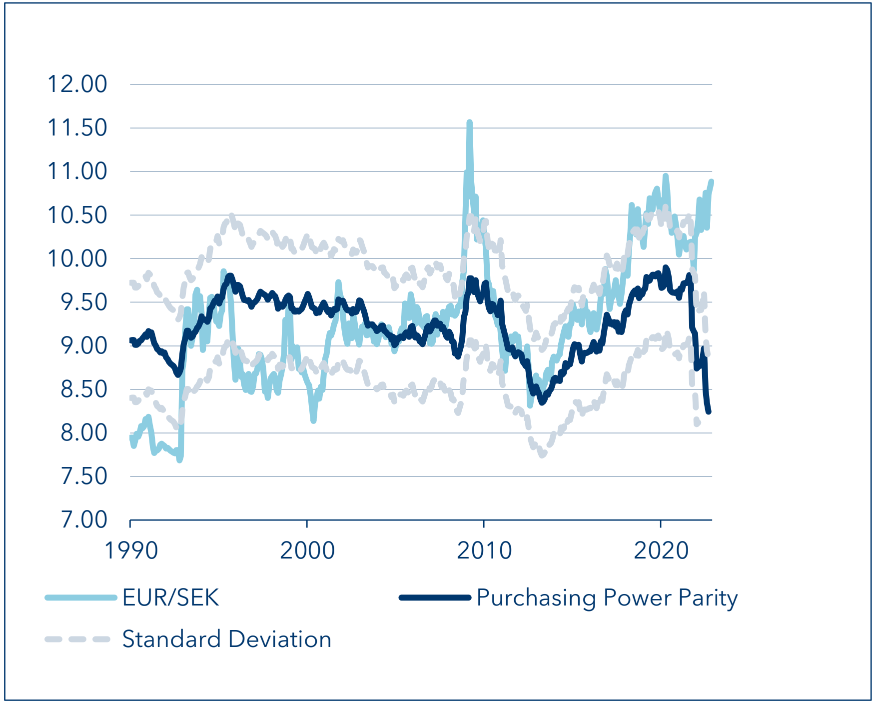
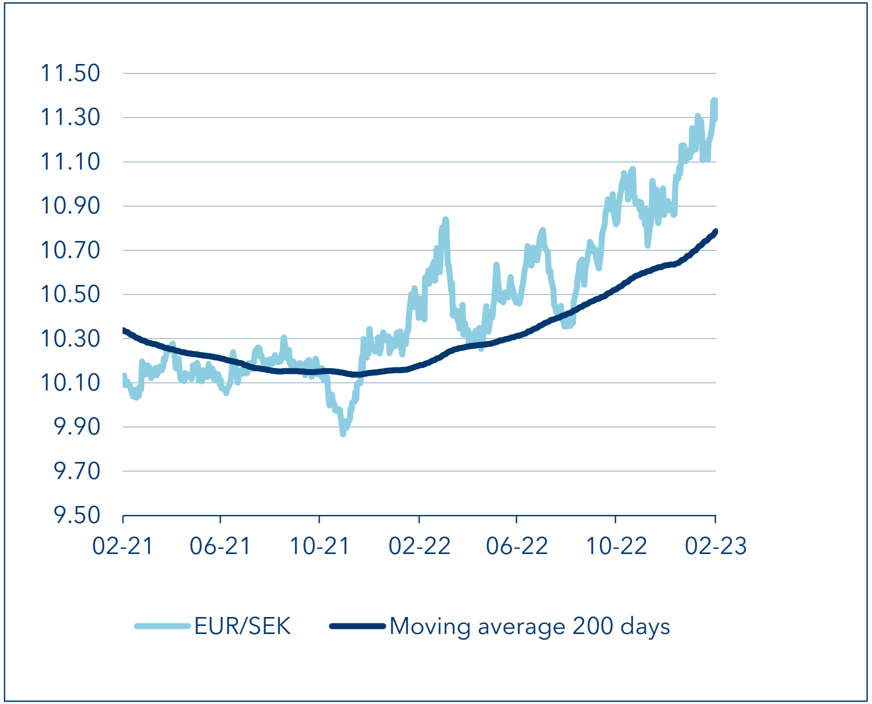



## Technical view



# 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.

**Source**: Bloomberg

## Important legal advice