Our View on Currencies

Edition October and November 2024

VP BANK

One uncertainty gives way to another

The cycle of interest rate cuts is in full swing. Except for the Bank of Japan, all major central banks are now lowering rates.

The most prominent among them, the US Federal Reserve, even cut its key interest rate by a substantial 50 basis points in September.

The question whether and when central banks will start easing has now turned into the question of how many rate cuts there will be in total. Whereas in previous cycles, central banks often gave a clear direction with a forward guidance, they now prefer to keep a low profile.

Inflationary pressures have not completely disappeared, and the economy is growing solidly, especially in the US. Although the European Central Bank (ECB) is facing a weak economy, prices in the services sector are still rising by more than 4%.

As a precaution, central bankers on both sides of the Atlantic say they want to take a data-dependent approach. However, it is not unusual for data to surprise on both the upside and the downside. Uncertainty in financial markets is correspondingly high.

We stick to it: as long as there is no clear path, currency market participants will remain on the sidelines. At least the question whether the Fed will tighten again first or cut interest rates from now on has been answered. The Fed has lowered the federal funds rate and thus weakened the dollar, albeit not significantly.

While uncertainty is decreasing, it is also increasing as the US presidential election is approaching with no obvious winner. All the more reason for forex traders to refrain from taking a clear position

Dr. Thomas Gitzel, **Chief Economist**

Our View on Currencies - Overview

Currency pairs

Our View on **EUR/USD**

1.08 – 1.14
Expected range
for 3 to 6 months

- Fed targets further rate cuts
- Inflation risks remain on both sides of the Atlantic
- Dollar remains in demand as a safe haven in uncertain times

- Larger-than-expected ECB rate cuts could significantly weaken the euro
- Financial markets expect a soft landing for the US economy; a hard landing could send the dollar into a tailspin

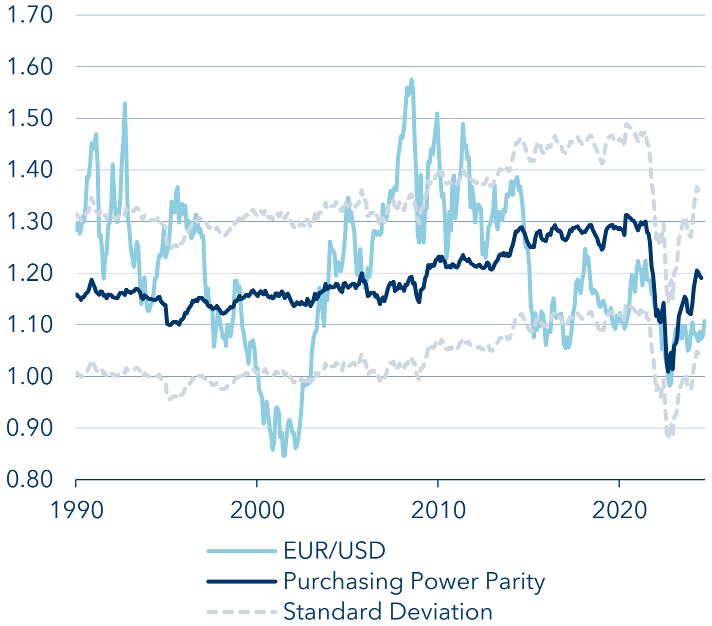
Focus on US elections

In recent weeks, the dollar has reacted to the Fed's expected and decided rate cuts. If Donald Trump were to win the election in November, which is by no means certain, the US dollar could strengthen. Trump wants to cut corporate taxes even more. This would likely strengthen equity markets and raise inflation expectations. A similar reaction was seen in 2016 when Trump was elected the first time. This would also have an impact on the Fed's decision-making. The US central bankers would probably be forced to act more cautiously. Kamala Harris' policies, on the other hand, are likely to be neutral for the Fed's monetary policy direction. The race for the White House is likely to be close. As a result, currency markets are unlikely to depreciate the dollar too much. Some dollar weakness is still possible given the rate cut.

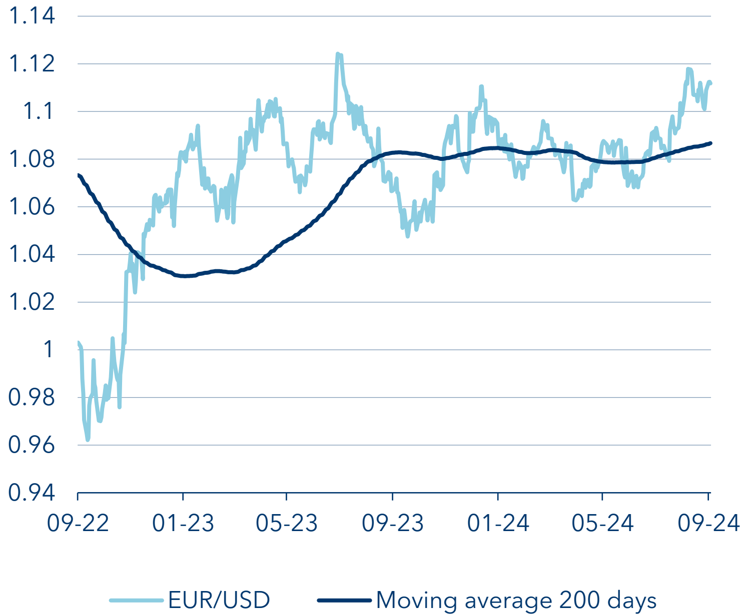
Our View on **EUR/USD**

1.08 – 1.14
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/CHF**

0.93 – 0.98
Expected range
for 3 to 6 months

- SNB likely to cut interest rate further - even below 1%
- ECB must act cautiously now, price pressures in services sector are high
- Market technicals point to franc weakness

- If the ECB were to cut rates more than expected, this could significantly weaken the euro
- A sudden flight to safety would weaken the euro against the franc

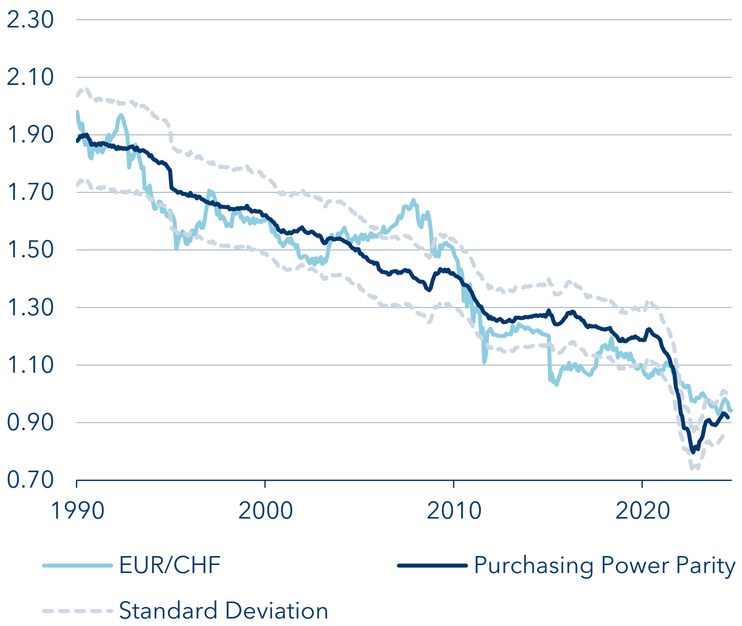
SNB cuts key rate again

Unlike the ECB or the Fed, the Swiss National Bank (SNB) does not have an inflation problem, but a disinflation one. This means that inflation is threatening to fall below the level desired by the SNB. If rents are excluded from the consumer price index, the latest inflation rate was only 0.4%. The strong franc makes imported goods cheaper and thus dampens overall inflation. This is precisely why we expect the SNB to continue its rate cuts. It is quite realistic that it will lower the key interest rate to 0.5%. The further easing of monetary policy should weaken the Swiss franc at least moderately. We therefore expect it to remain above 0.95 against the euro over the next three to six months.

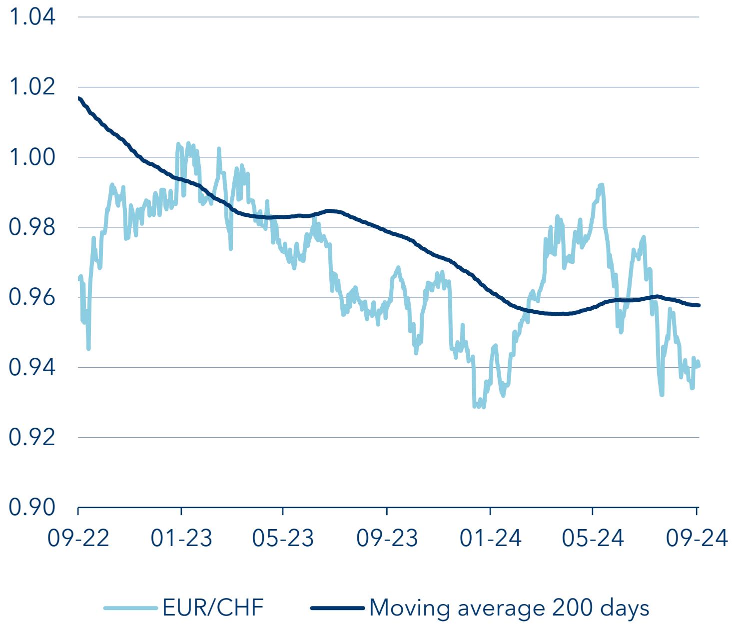
Our View on **EUR/CHF**

0.93 – 0.98
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **USD/CHF**

0.83 – 0.92
Expected range
for 3 to 6 months

- Both currencies are in demand in times of high uncertainty
- Robust US economy and geopolitical risks favour the dollar

- If the US economy were to fall into recession after all, the Fed could cut interest rates more sharply than previously expected and the dollar would come under pressure
- Purchasing power parity speaks in favour of a significantly stronger franc

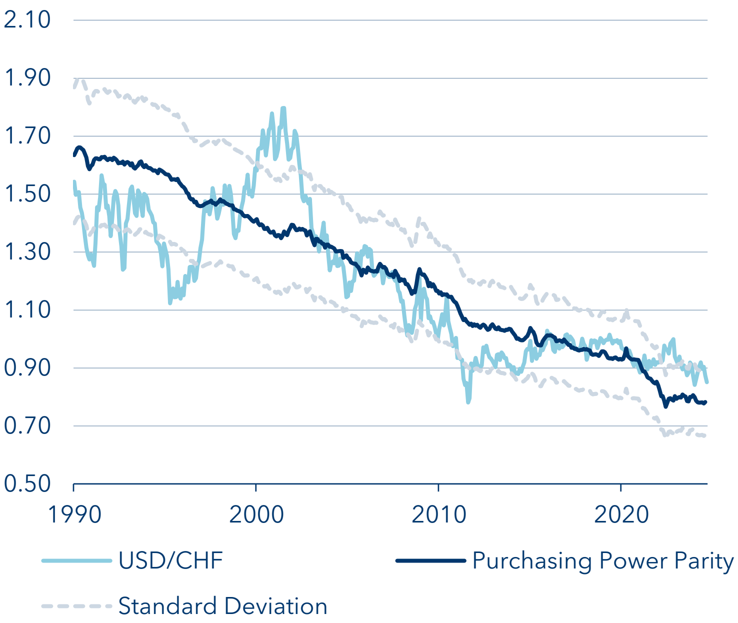
Uncertain policy path in the US

The prospect of lower interest rates is weighing on the dollar. It remains to be seen how quickly and, more importantly, by how much the Fed will cut rates in the medium term. After a larger-than-expected 50bp cut in September, the Fed is aiming for a further 150bp by the end of 2025. The US economy is currently robust, even at very high interest rates, and lower rates could even prolong the growth phase. The path of the Fed's rate cuts therefore remains uncertain. As the SNB is likely to continue easing, with a rate of 0.5% now even likely, the dollar could benefit again in the coming months. We expect the dollar to rise above 0.85 against the Swiss franc. However, there are no signs of a significant weakening of the Swiss franc.

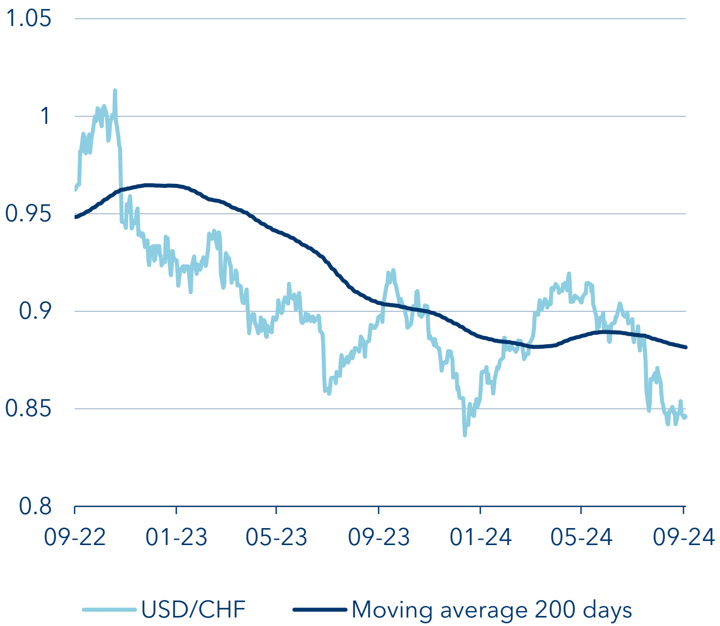
Our View on **USD/CHF**

0.83 – 0.92
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **GBP/USD**

1.26 – 1.34
Expected range
for 3 to 6 months

- The pound is clearly undervalued against the dollar
- The dollar is weakened by rate cut expectations

- Brexit is reducing the UK's potential growth, which prevents a significant appreciation of pound
- GBP remains fundamentally under pressure due to a weaker economic development in the UK

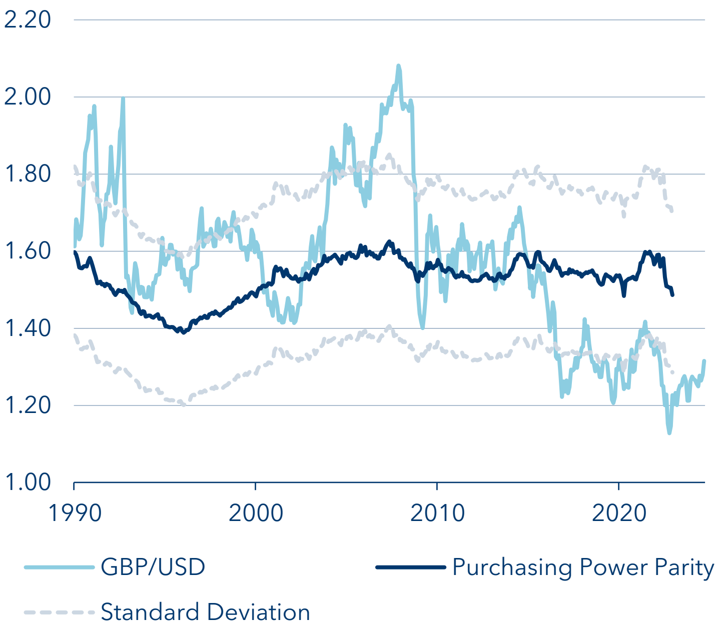
Good data at first glance

The UK economy grew by 0.6% in the second quarter on a quarter-on-quarter basis. It had already grown by a strong 0.7% in the first three months. The economy therefore performed better than expected. However, part of the growth was due to a strong increase in government spending. Investment in equipment also rebounded sharply after declining in the first quarter. At the same time, inflation rates remain relatively high. Although the latest headline inflation rate of 2.2% looks low, it still stands at 3.6% if volatile energy and food prices are excluded. At first glance, therefore, the UK data looks encouraging, but on closer inspection neither the growth drivers nor the inflation trend are convincing. We expect the pound to continue to make some gains against the dollar, but this will be mainly due to the weaker greenback.

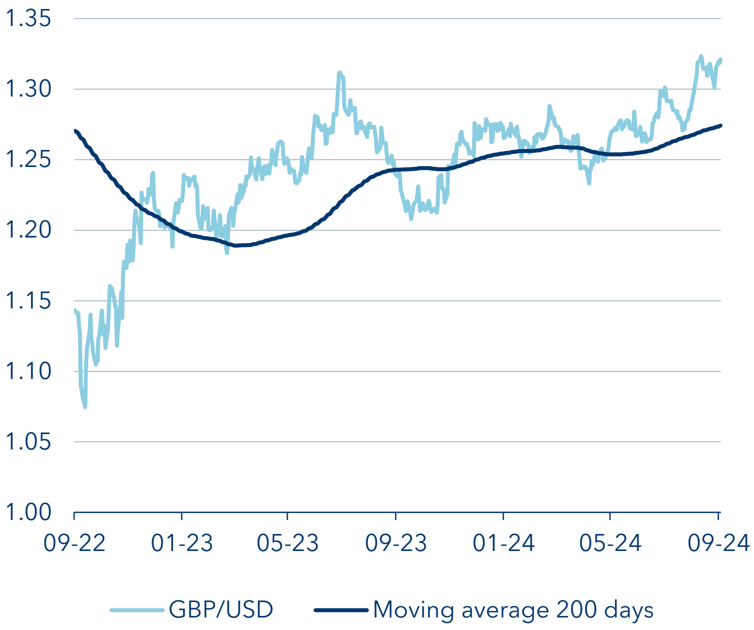
Our View on **GBP/USD**

1.26 – 1.34
Expected range
for 3 to 6 months

Purchasing power parity (producer prices; monthly data)



Technical view



Our View on **EUR/SEK**

10.80 – 11.80
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 fight the still high inflation would weaken the euro

- Currently still unfavorable environment for high-beta currencies such as the SEK
- Swedish central bank sees more room for rate cuts this year

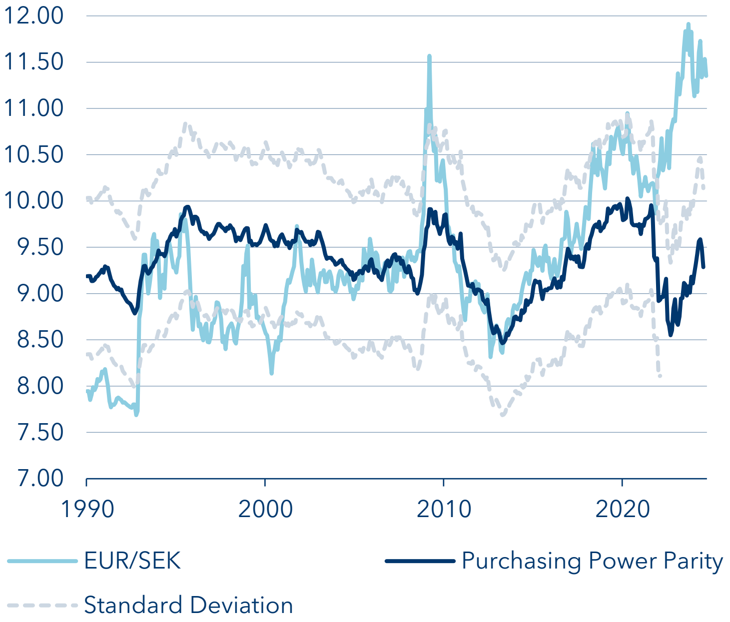
Less support from the Riksbank

The stock market turmoil at the end of July took the Swedish krona to about 11.80, followed by an appreciation towards 11.30. This confirms that the krona is highly dependent on the global environment. Meanwhile, the Swedish central bank (Riksbank) continues to cut interest rates. Following the rate cut in August, the central bank lowered its key interest rate again by 25 basis points in September. Further cuts are likely to follow this year, with the policy makers signalling further monetary easing. The Riksbank's preferred measure of inflation, the consumer price index with a fixed interest rate (CPIF), recently stood at 1.2 %, well below the inflation target of 2 %. The krona will therefore no longer receive a lot of support from the interest rate side. We expect the sideways movement to continue.

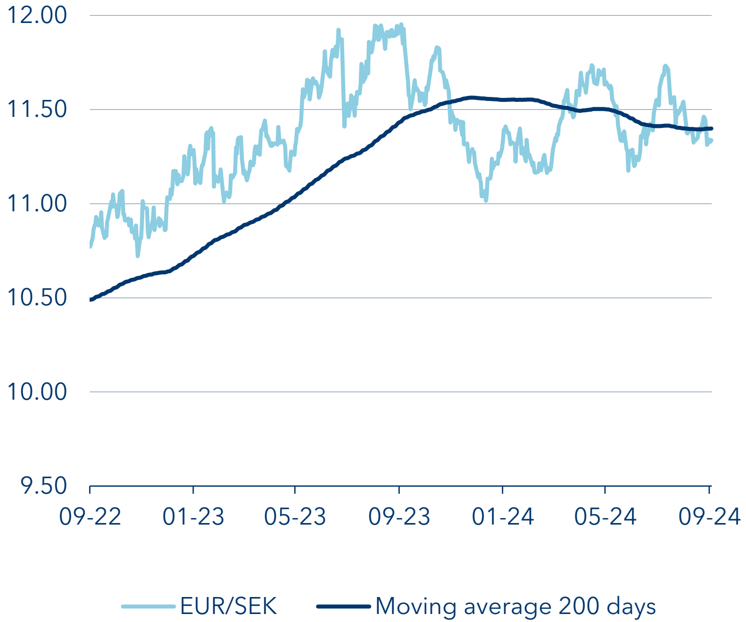
Our View on **EUR/SEK**

10.80 – 11.80
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

This documentation was produced by VP Bank AG (hereinafter the bank) and distributed by the companies of the VP Bank Group. This documentation does not constitute an offer or an invitation to purchase or sell financial instruments. The recommendations, estimates and statements contained therein reflect the personal views of the relevant analyst of VP Bank AG at the time of the date stated on the documentation and can be changed at any time without prior notice. The documentation is based on information that is considered reliable. This documentation and the assessments or assessments made therein are prepared with the utmost care, but their accuracy, completeness and accuracy cannot be guaranteed or guaranteed. In particular, the information contained in this documentation may not include all relevant information on the financial instruments covered or their issuers.

For more important information on the risks associated with the financial instruments in this documentation, the proprietary business of the VP Bank Group or the management of conflicts of interest in relation to these financial instruments, and for the distribution of this documentation, see
https://www.vpbank.com/legal_notes