Forex News

EURUSD - US dollar should remain firm for now
EURJPY - yen strengthens in line with lower EZ yields
EURCHF – Swiss franc increasingly under appreciation pressure

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US interest rate trends and political risks in Europe are currently in focus

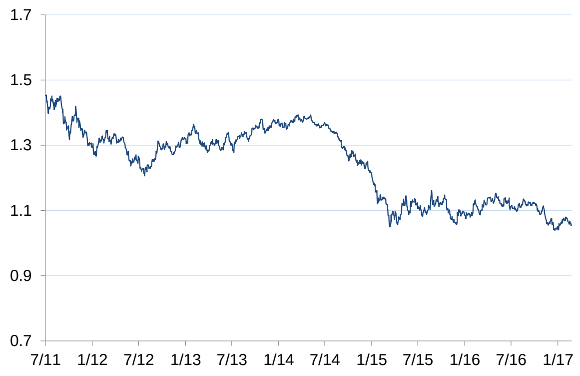
EURUSD strengthened to slightly above the level of 1.08 at the end of January, but the euro has declined to the 1.05 dollar level again since then. The reasons for this were rising US interest rate expectations and growing political risks in the euro zone. In mid-March parliamentary elections are coming up in the Netherlands, at the end of April presidential elections will be held in France, and the risk that early new elections will be called in Italy continues to linger. All these (potential) elections will be contested by strongly nationalist anti-EU movements. Overall, these factors appear to weigh more heavily from the perspective of the markets than the risks associated with the presidency of Donald Trump.

We expect the dollar to maintain its strength in coming weeks. We are lowering our end-of-March forecast for EURUSD from 1.08 to 1.05, in light of the markets assigning greater importance to European political risks, while risks in the US (surprisingly) remain on the back-burner so far. Concurrently with the elections in the Netherlands the FOMC will hold its next meeting, and should provide stronger indications of an impending rate hike in the second quarter. We are cautious with respect to additional dollar appreciation potential over the remainder of the year. We expect three rate hikes in the US, which the markets have largely priced in by now though. In addition, strong economic data releases should continue to emerge from the euro zone, hence we expect the dollar to weaken somewhat again over the remainder of the year. We see the greatest risk to our forecast in a larger than expected surge in US consumer price inflation, which would lead to a stronger dollar.

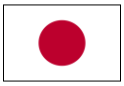
EURUSD – since 2000

Source: Bloomberg, Erste Group Research

EURUSD – since July 2011



Source: Bloomberg, Erste Group Research



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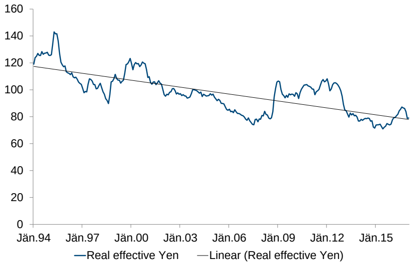
JPY – yen strengthens in line with lower yields in the euro zone

With respect to the monetary policy stance of the Bank of Japan, no significant changes were announced at its last meeting (31. January 2017). In order to achieve its inflation objective of 2% as soon as possible, the BoJ continues to rely on negative deposit rates, QE (around JPY 80 trn. per year), as well as control of the yield curve. Should the uptrend in US bond yields continue in line with our expectations, control of the yield curve with the aim of keeping 10 year JGB yields close to 0% could become an increasingly more challenging task for the BoJ. So far in 2017, JGB yields have already increased to the vicinity of 0.1%.

Trade-weighted real effective exchange rate of the yen (as of January 2017)



Source: BIS, Erste Group Research

As we expected, a rapid decline in 10-year government note yields in the US and the euro zone until 08. February resulted in appreciation pressure on the yen. While yields in US treasuries have increased again since then, yields in the euro zone have remained close to their February lows (triggered by political risks). Therefore, pressure on the yen to strengthen against the euro persists. Given the BoJ's intention of holding 10-year JGB yields close to 0%, we believe the yen will weaken again if yields in the euro zone rise. Conversely, if yields in the euro zone were to decline, the yen should appreciate further, similar to the trend that could be observed recently. Following a recent bout of weakness, the yen's real effective exchange rate against a broad basket of currencies is close to its long term trend again since the end of January.

From a technical perspective the support level near 120 has failed to hold and the yen is gradually moving toward 119 and lower levels at the moment. The next important support will be encountered around the 117 level, close to the currently slightly downward sloping 200-day moving average. In the event of a renewed uptrend taking hold, the level of 123 currently represents strong resistance. According to Bloomerg, the analyst consensus at present expects the yen to trade at 123 against the euro by Q4 2017.

EURJPY – since 2000

Source: Bloomberg, Erste Group Research

EURJPY – since July 2011

Source: Bloomberg, Erste Group Research

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EURCHF – Swiss franc increasingly under appreciation pressure

After several attempts, the Swiss franc finally moved decisively below the 1.07 level against the euro. So far the level of 1.064 represents support, but appreciation pressure on the CHF evidently persists, as almost no counter-trend movements were in evidence in recent trading days. Similar to the euro zone, confidence in the Swiss manufacturing sector has clearly moved into expansion territory in January again. Consumer confidence is rising as well. Thus the federal statistical office of Switzerland expects that Swiss GDP growth will accelerate to +1.8% in 2017, in line with global trends. However, the pace of inflation (+0.3% y/y as of January) continues to lag significantly behind that of the euro zone.

In the short term, fundamental factors provide no evidence that appreciation pressure on the Swiss franc is likely to recede significantly. The revision of the SNB's conditional inflation forecast in December indicates that an increase in the inflation differential between Switzerland and the euro zone should be expected. Moreover, political risks in the euro zone are leading to heightened uncertainty, hence sovereign spreads of peripheral EZ countries and France over German Bunds have recently widened again. As a result of this, the Swiss franc continues to be seen as an attractive safe haven currency despite negative deposit rates. In recent weeks the surge in sight deposits at Swiss banks has accelerated noticeably. The SNB continues to stress that the Swiss franc remains significantly overvalued and that it will "...remain active in foreign exchange markets as necessary". In view of the fundamental data and the situation in financial markets, we are revising our forecast for EURCHF slightly downward. In our assessment EURCHF should fluctuate between 1.055 and 1.07 in coming months. Should the current support level at 1.064 fail to hold, a short term move to the next support level around 1.055 appears possible from a technical perspective. If no political risks materialize, investors should become increasingly more risk tolerant toward the euro zone as the year progresses though, in line with the ongoing global economic recovery. That should lend support to the euro, and we expect the Swiss franc to weaken year-over-year to around EURCHF 1.09 by Q4 2017. However, a minimum exchange rate is no longer enforced. Should certain risks materialize (e.g. geopolitical conflicts, political turmoil in the EU), the Swiss franc could once again appreciate rapidly and strongly.

EURCHF – since 2000

Source: Bloomberg, Erste Group Research

EURCHF – since July 2011

Source: Bloomberg, Erste Group Research

Exchange rate forecasts[1]

Currency	current	Mar.17	Jun.17	Sep.17	Dec.17
EURUSD	1.05	1.05	1.08	1.10	1.12
EURCHF	1.07	1.06	1.07	1.08	1.09

EURJPY	current	Mar.17	Jun.17	Sep.17	Dec.17
Bloomberg Survey		121.0	121.0	122.0	123.0
Spot/Forward	119.4	120.0	120.0	120.0	120.0

Source: Bloomberg, Erste Group Research

Interest rate forecasts

	current	Mar.17	Jun.17	Sep.17	Dec.17
3M Euribor	-0.33	-0.30	-0.30	-0.30	-0.30
3M Libor US	1.05	1.00	1.30	1.50	1.80
3M Libor CH	-0.73	-0.75	-0.75	-0.75	-0.75

Source: Bloomberg, Erste Group Research

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

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