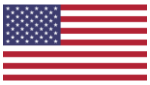
Forex News

EURUSD - Outcome of French elections boosts euro
EURJPY – Yen weakens in line with higher EZ bond yields
EURCHF – Appreciation pressure eases further



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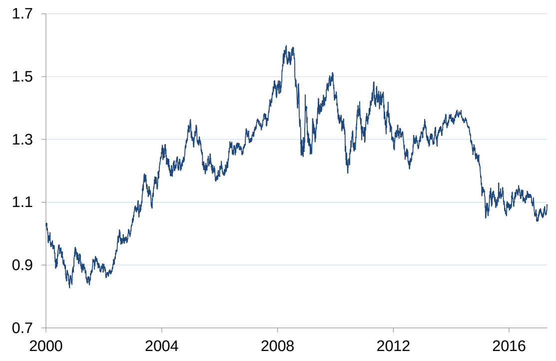
Gradual weakening of the US dollar should continue

In the wake of the first round of the French presidential election the euro posted significant gains against the US dollar. The rationale for this was that Emmanuel Macron is perceived as highly likely to win the run-off election against Marine le Pen on 07. May, which would leave France firmly embedded in the EU and the euro zone. That reduced the risks for the euro, and the common currency strengthened against the dollar accordingly.

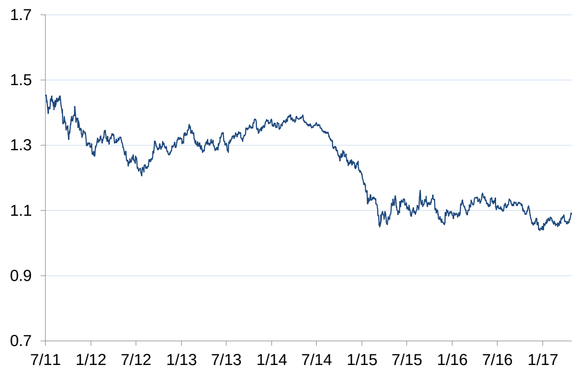
We maintain our outlook for EURUSD over coming months. We continue to expect a mild upward trend in EURUSD, i.e., a gradual weakening of the dollar. This expectation is mainly based on the fact that the dollar is already trading at a very high valuation, which we derive from the interest rate differential between the two currency areas (based on 2 yr. real yields). In our assessment this suggests that the dollar will tend to weaken. Only a significant surge in US interest rate expectations could potentially alter the situation, but there is currently no evidence supporting such a scenario. On the contrary: US economic growth appears to have slowed substantially in the first quarter of 2017. Overall, recent data releases have confirmed the developments we anticipated, as well as our forecast. Nevertheless, the degree of uncertainty attending medium-term forecasts of EURUSD should not be underestimated. Apart from geopolitical crises that would lead to a firming of the dollar, there is a risk that inflation could increase due to the already low US unemployment rate, and which could be stoked further by tax cuts. In that case the Federal Reserve would have to rapidly hike interest rates in order to keep pace, which would in turn lead to a stronger dollar. However, as noted above, this is not the scenario we regard as having the highest probability.

EURUSD – since 2000



Source: Bloomberg, Erste Group Research

EURUSD – since July 2011



Source: Bloomberg, Erste Group Research

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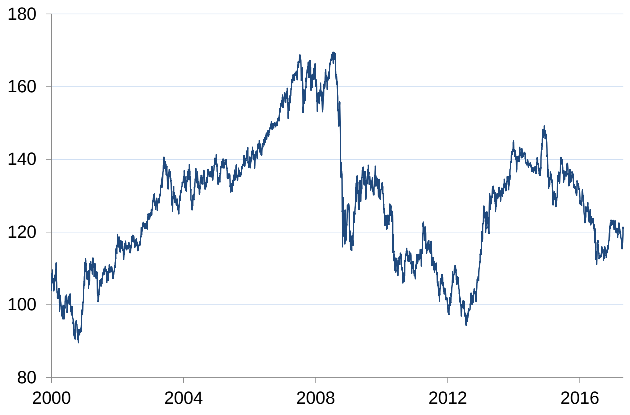
JPY – yen weakens in line with higher euro zone bond yields

The Bank of Japan announced no noteworthy changes to monetary policy at its last meeting (18. March 2017). In order to achieve its inflation objective of 2% as soon as possible (most recent reading: +0.2% y/y), the BoJ continues to rely on negative deposit rates, QE (approx. JPY 80 trn. per year), as well as control of the yield curve. The latter means that the BoJ wishes to continue to peg 10-year JGB yields near 0%.

After the first round of the French presidential elections produced an outcome in line with expectations, tensions in European financial markets eased significantly, and yields on 10-year German Bunds consequently rose as well. As a result of this their spread over Japanese yields widened (yields on 10-year JGBs around 0%), which in turn led to strong gains in the euro against the yen to above the 120 level (from 117 previously). As populist political movements in Europe are losing momentum of late, political risks in the euro zone are currently in retreat. We expect this to be reflected by a gradual increase in euro zone bond yields in coming months, supported by the strong performance of the economy as well. As long as the BoJ continues its policy of controlling the yield curve, this suggests the yen should weaken further against the euro in coming months.

However, amid a general increase in financial market risk, appreciation pressures on the yen could re-emerge at any time. From a technical perspective strong resistance is currently provided by the 122-123 level. Should it be overcome, a rapid move toward the 127 level could well ensue. Should the yen strengthen, the first support area in EURJPY is located around the 115 level. According to Bloomberg, the analyst consensus is calling for the yen to trade at 123 against the euro in Q4 2017.

EURJPY – since 2000



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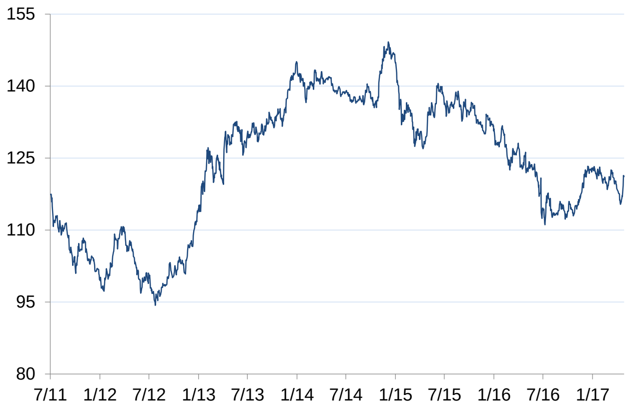
EURJPY – since July 2011



Source: Bloomberg, Erste Group Research

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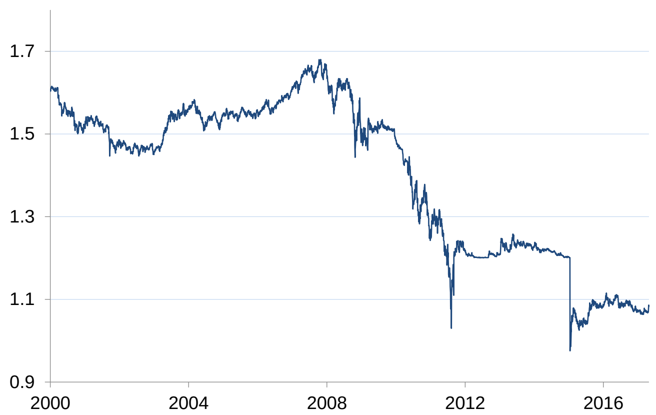
EURCHF – Appreciation pressure eases further

At its last meeting the Swiss National Bank confirmed it would maintain its expansionary monetary policy. The target range for three month Libor remained at -1.25% to -0.25% and interest on sight deposits with the central bank was kept unchanged at a negative rate of -0.75%. According to statements by the SNB, the Swiss franc continues to be significantly overvalued. Due to the increase in oil prices, the SNB has slightly raised its conditional short term inflation forecast.

Fundamental factors have barely changed. The revised inflation forecast published by the SNB in March continues to suggest that a further widening of the inflation differential between Switzerland and the euro zone should be expected in 2017; a moderate tightening should only be seen by 2018. However, the easing of tensions in financial markets in the wake of the first round of the French presidential election has triggered a strong reaction in the EURCHF cross rate. The Swiss franc weakened markedly to beyond the 1.08 level, as the Swiss franc lost quite a bit of its attractiveness as a safe haven. In such an environment the necessity for the SNB to actively intervene in foreign exchange markets obviously decreases as well.

From a technical perspective the exchange rate appears to have established a firm foothold above the 1.08 level. The next short term resistance zones in EURCHF are at the 1.09 and 1.10 levels. If no unexpected political risks materialize, the risk tolerance of investors toward the euro zone should increase in line with the global economic upswing as the year progresses. That should lend support to the euro and we expect the Swiss franc to weaken to around 1.10 Swiss francs per euro by Q4 2017. However, a minimum exchange rate is no longer enforced. Should certain risks emerge (e.g. geopolitical conflicts, turmoil in the EU), the Swiss franc could once again appreciate rapidly and strongly.

EURCHF – since 2000



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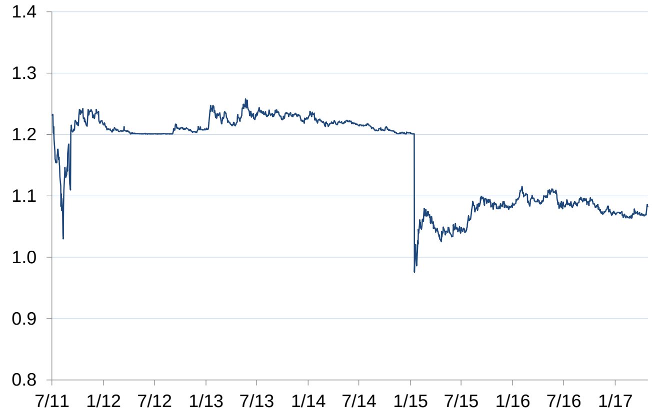
EURCHF – since July 2011



Source: Bloomberg, Erste Group Research

Exchange rate forecasts[1]

Currency	current	Jun.17	Sep.17	Dec.17	Mar.18
EURUSD	1.09	1.08	1.10	1.12	1.12
EURCHF	1.08	1.08	1.09	1.10	1.11

EURJPY	current	Jun.17	Sep.17	Dec.17	Mar.18
Bloomberg Survey		120.0	121.0	121.0	122.0
Spot/Forward	121.1	120.0	120.0	120.0	121.0

Source: Bloomberg, Erste Group Research

Interest rate forecasts

	current	Jun.17	Sep.17	Dec.17	Mar.18
3M Euribor	-0.33	-0.30	-0.30	-0.30	-0.30
3M Libor US	1.17	1.20	1.40	1.70	1.90
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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