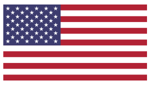
Forex News

EURUSD – Upcoming decisions of central banks decisive
EURJPY – Yen continues to weaken
EURCHF – SNB acknowledges overvaluation has been reduced to some extent



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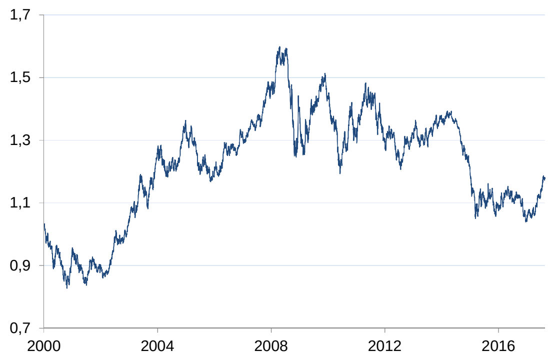
Monetary policy divergence favoring the US dollar

After a rapid advance in the course of July, EURUSD fluctuated around the 1.18 level in August and around the 1.19 level in September. The rally has therefore basically transitioned into a sideways trading range. However, no signs of a counter-trend move are evident yet. We continue to believe that the US dollar should strengthen again.

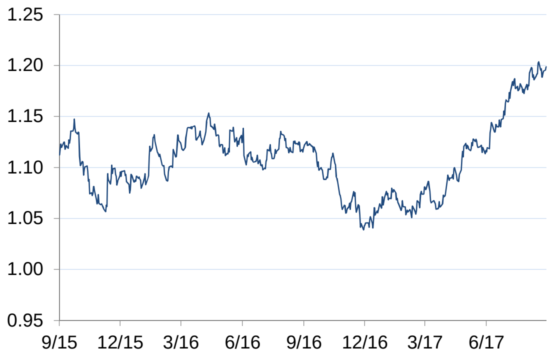
There are several reasons for this from our perspective. Most important are our expectations regarding the monetary policy decisions of the two relevant central banks. Up to now markets have been speculating over the next steps of the central banks. During the coming weeks both the US-Fed and the ECB will make decisions, crucial for the path of EURUSD. We expect another US rate hike before the end of the year. The implied rate hike probability priced in by the markets stands at just 50% and a correction of these expectations would support the US dollar. The monetary policy stance signaled on occasion of the FOMC meeting on September 20 will be the determining factor driving interest rate expectations and hence crucial for EURUSD. The next important meeting of the ECB Council is scheduled for October 26. According to its statements, that is when the ECB is going to probably make a decision regarding its asset purchase program next year. Surveys indicate that a majority of market participants expects ECB securities purchases to be reduced from January onward. We believe the ECB will only implement this step in April and is therefore going to disappoint market expectations. The strength in the euro has actually increased the probability of such a delay, as it has created a more restrictive monetary policy, which will be taken into account by the ECB. Thus strength in the euro recursively undermines its own premise, which is another reason for our expectation that the euro is set to weaken.

EURUSD – since 2000



Source: Bloomberg, Erste Group Research

EURUSD – two years



Source: Bloomberg, Erste Group Research

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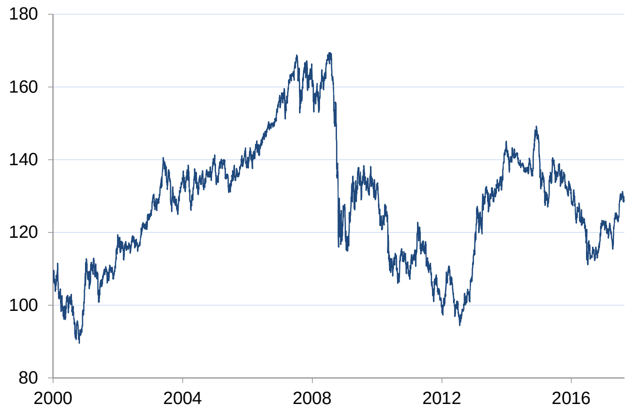
JPY – Yen weakens further

The Bank of Japan announced no significant changes with respect to its monetary policy stance at its last meeting (20. July 2017). In order to achieve its inflation objective of 2% as soon as possible (recently inflation continued to accelerate to +0.5% 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 wants to continue to peg 10-year JGB yields near 0%.

In recent months economic conditions in Japan have brightened as well, and what's more, a steady uptrend in the inflation rate has emerged since the end of 2016. As a result of the surge in inflation, the attractiveness of investments in JPY is steadily decreasing in view the BoJ's policy of controlling the yield curve. Moreover, the global economic recovery has boosted the confidence of Japanese investors in overseas investment. Based on the continuing economic upswing in the euro zone, as well as our expectation of a moderate increase in core inflation, we estimate that the yield on 10-year German Bunds will rise to 0.8% by the end of the year. From a fundamental perspective, this suggests that the yen should continue to weaken against the euro in coming months, as long as the BoJ doesn't alter its monetary policy stance and the inflation rate continues to increase in Japan as well.

Similar to the fundamental backdrop, the technical picture currently also indicates that the yen should weaken further against the euro. Both the 200- and 50-day moving averages are currently rising. In September the cross rate has overcome resistance at the 131 level. The next upside resistance area is the 134 to 135 range. In the event of a general increase in financial market risks, further appreciation pressure on the yen can nevertheless emerge at any time. The Bloomberg analyst consensus currently calls for the EURJPY cross to trade at 131 by Q4 2017.

EURJPY – since 2000



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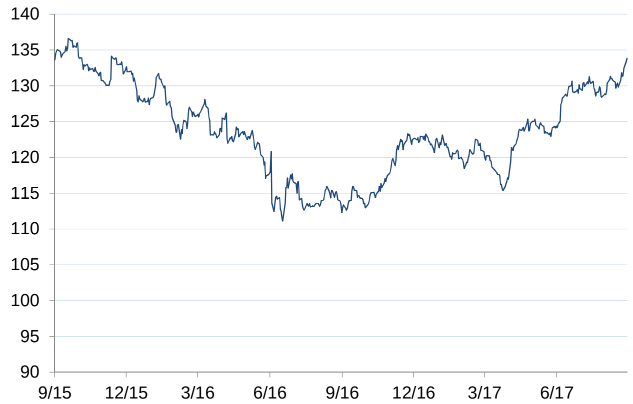
EURJPY – two years



Source: Bloomberg, Erste Group Research

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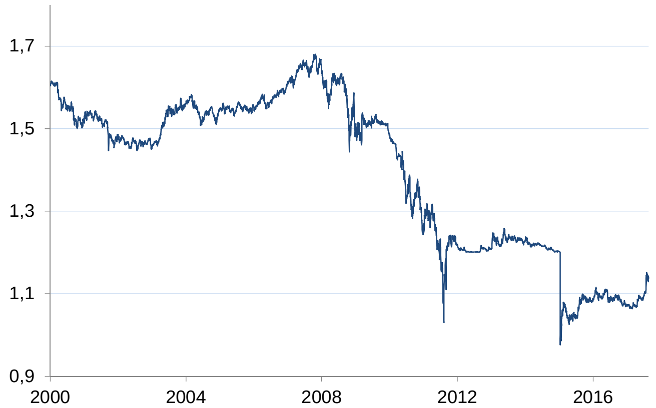
EURCHF – SNB acknowledges overvaluation has been reduced to some extent

On September 14 the Swiss National Bank left the target range for three month Libor between -1.25% and -0.25%, while interest on sight deposits with the central bank was kept unchanged at a negative rate of -0.75%. The SNB acknowledged that the recent weakening of the Swiss franc against the euro has to some extent contributed to a reduction in the Swiss franc's significant overvaluation. However, according to the SNB's assessment, the valuation of the Swiss franc remains elevated and the situation in foreign exchange markets remains “fragile”. Thus the SNB continues to stand ready to intervene in foreign exchange markets if necessary, in order to reduce to attractiveness of the Swiss franc as an investment destination.
Due to the recent trend in the exchange rate, there was a slight upward revision in the conditional inflation forecast. The SNB now expects inflation to average +0.4% in both 2017 and 2018. Given the recent 0.1% downward revision of the ECB's inflation forecast to 1.2%, the inflation differential between Switzerland and the euro zone appears set to tighten a bit faster than hitherto expected.

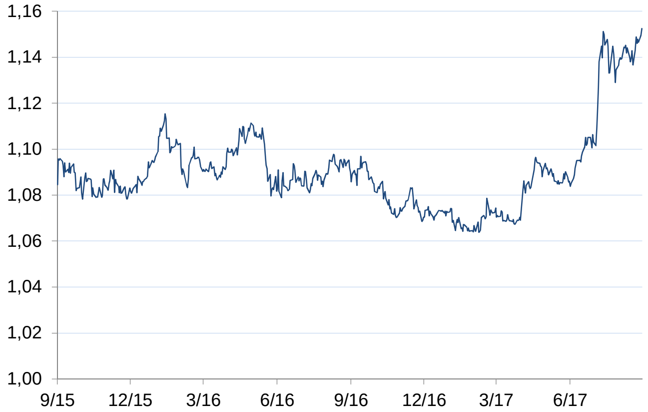
We believe the significant appreciation of the euro vs. the Swiss franc reflects for one thing that political risks in the euro zone have decreased, and for another thing the strong momentum of economic growth in the euro zone. As a result of the latter, core inflation in the euro area has gradually increased in the past several months, which has generated mild upward pressure on yields on the long end of the curve. Based on our forecast of a continuation of the economic upswing in the euro area in coming months, as well as a further rise in long term euro zone bond yields, additional downward pressure on the Swiss franc appears likely from a fundamental perspective. Technically the cross rate is now close to important resistance at the 1.15 level. Should this level be overcome convincingly, we believe a rapid move toward 1.18 to 1.20 could ensue (based on the lack of lateral resistance in this area). Should EURCHF fail to surmount resistance, a continued sideways move in the recent trading range between 1.13 to 1.15 seems to be the most realistic outcome from a technical perspective. We expect EURCHF to trade at 1.16 by the end of the year. 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



Source: Bloomberg, Erste Group Research

EURCHF – two years



Source: Bloomberg, Erste Group Research

Exchange rate forecasts[1]

Currency	current	Dec.17	Mar.18	Jun.18	Sep.18
EURUSD	1.20	1.15	1.13	1.14	1.16
EURCHF	1.15	1.16	1.17	1.17	1.18

EURJPY	current	Dec.17	Mar.18	Jun.18	Sep.18
Bloomberg Survey		131.0	132.0	133.0	133.0
Spot/Forward	133.8	133.0	133.0	133.0	133.0

Source: Bloomberg, Erste Group Research

Interest rate forecasts

	current	Dec.17	Mar.18	Jun.18	Sep.18
3M Euribor	-0.33	-0.30	-0.30	-0.30	-0.30
3M Libor US	1.32	1.70	1.90	2.20	2.40
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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