

Foreign Exchange News

EURUSD - Rise of US interest rate expectations precondition for a stronger dollar

EURJPY - Yen in a tight trading range

EURCHF - According to SNB, Swiss franc remains overvalued



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EURUSD moving sideways in recent weeks

There has been little movement in EURUSD over recent weeks. The exchange rate remained in a fairly tight trading range. Contrary to August, stock market volatility scarcely had any influence. At the most recent meeting of the Federal Reserve's open market committee (FOMC) in mid September, a first rate hike was once again postponed, a decision most market participants had expected due to financial market turmoil. However, the recent weakness in US employment data was a surprise, upon which - from our perspective - already subdued US interest rate expectations softened even further, without leading to a sustained weakening of the dollar, resp. strengthening of the euro. Evidently the markets are shying away from betting on the euro, as the ECB's ongoing securities purchase program represents a negative factor, and there is a risk that it could be expanded. Thus the market is only likely to get moving again once interest rate expectations in the US are firming up. We expect this shift to eventually occur, as the recent bout of economic weakness in the US should only be temporary. Should the ECB expand its asset purchase program (which we don't expect), pressure would be put on the euro vs. the dollar as well. All in all, we expect the dollar to post moderate gains in coming months, which shouldn't last either. A too pronounced dollar appreciation would affect the US economy negatively, which in turn would weigh on interest rate expectations, while in the course of the coming year the end of the ECB's purchase program should come into view and lend fresh support to the euro.

EURUSD – since 2000

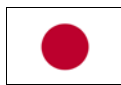


Source: Bloomberg, Erste Group Research

EURUSD – since July 2011



Source: Bloomberg, Erste Group Research



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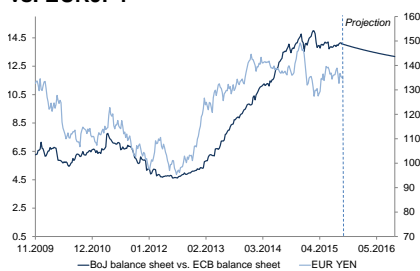
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JPY – Yen remains little changed

After a disappointing economic performance in the 2nd quarter (-0.3% q/q), leading indicators for the 3rd quarter released to date are providing mixed signals for Japan's economy. Consumer confidence in the months July and August (stable relative to the 2nd quarter average) is pointing to a continuation of weak consumer spending in the 3rd quarter. By contrast, the manufacturing purchasing managers index has exhibited a positive trend in the 3rd quarter and suggests a moderate increase in industrial production.

The Inflation rate has declined to -0.1% in August (0.0% previously). Due to the dampening effect of low energy prices, members of the board of the Bank of Japan (BoJ) continue to expect that the price stability target of 2% will be reached in the course of the first half of 2016. At the last BoJ meeting in July, a clear majority of the members has voted in favor of continuing the asset purchase program at the same level (JPY 80 trn. p.a.), until the price stability target of 2% is attained.

BoJ balance sheet / ECB balance sheet vs. EURJPY



Source: Bloomberg, Erste Group Research

In recent weeks the yen has continued to move in a tight trading range between 133 and 137 to the euro. Since 2009 a correlation between the ratio of the central bank balance sheets of BoJ and ECB and the EURJPY exchange rate could be observed. Concurrently with the ECB's announcement that it would begin to implement QE at the beginning of this year as well, the euro started to gradually decline from its previous peak of 150 vs. the yen. In the event that both the ECB and the BoJ continue to carry out their purchase programs until autumn of 2016 as planned, a relatively stable ratio between the two central bank balance sheets would result (with a slight declining trend due to the somewhat faster pace of the ECB's purchases). This would argue in favor of continued stability in the exchange rate, as long as no material change in monetary policy in Japan or the euro zone is implemented. The technical picture continues to be mixed. The cross rate trades slightly above its by now flat 150-day moving average. The trading range has recently moved a bit lower toward 133-137 (from 135-139 previously). On the upside the level around 140 continues to represent substantial resistance, while there is strong support in the region of 132-133. From a technical perspective the yen is therefore in neutral territory and the odds of a depreciation or an appreciation stand at 50:50 at the moment. The analyst consensus currently expects a slight decrease in the cross rate to around EURJPY 133 until year-end.

EURJPY – since 2000



Source: Bloomberg, Erste Group Research

EURJPY – since July 2011



Source: Bloomberg, Erste Group Research



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Margarita Grushanina*margarita.grushanina@erstegroup.com***EURCHF – according to SNB, the Swiss franc remains overvalued**

In its quarterly monetary policy assessment of September 17, the SNB has left the target range for three month LIBOR unchanged at -1.25% to -0.25%, as well as leaving the interest rate on sight deposits with the central bank at -0.75%. According to the SNB's assessment, "...despite a slight depreciation, the Swiss franc remains significantly overvalued". Fritz Zurbrugg has used even stronger terms in a presentation delivered on October 1, asserting that "the Swiss franc's overvaluation....is currently especially pronounced". The SNB has altered its choice of words in the monetary policy assessment and has explicitly emphasized that it will remain active in the foreign exchange markets, "in order to take account of the impact of the exchange rate situation on inflation and economic developments". Negative interest rates and the central bank's readiness to intervene, if necessary, in foreign exchange markets are designed to make Swiss franc investments less attractive.

The SNB has also slightly lowered its conditional inflation forecast, primarily due to the decline in oil prices. An inflation rate of -1.2% resp. -0.5% is now expected in 2015 and 2016 (June forecast: -1.0% and -0.4%). The SNB's inflation forecast for 2017 stands at 0.4%. Contrary to the SNB, SECO expects a positive inflation rate of 0.1% in 2016 already. In spite of the moderate easing of the exchange rate situation in recent weeks, SECO expects that the economy's performance will remain quite subdued in the second half of 2015, and should only strengthen in 2016. SECO expects GDP growth of 0.9% in 2015, followed by an acceleration to 1.5% in 2016.

Since the end of July a slight, but noticeable weakening of the Swiss franc could be observed. The trigger for this was the easing of tensions with respect to the situation surrounding Greece, and consequently a decrease in safe haven flows. In addition to this, the effects of negative interest rates are slowly but surely exerting pressure, making the Swiss franc less attractive as an investment. For the next four quarters we expect a further moderate decline in the Swiss franc (September 2016e EURCHF: 1.16). However, the minimum exchange rate is no longer enforced. Should certain risks become manifest (e.g. geopolitical conflicts, turmoil in the euro zone), 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

	current	Dec.15	Mar.16	Jun.16	Sep.16
EURUSD	1.12	1.08	1.10	1.12	1.14
EURCHF	1.09	1.11	1.13	1.15	1.16

Source: Bloomberg, Erste Group Research

EURJPY	current	Dec.15	Mar.16	Jun.16	Sep.16
Bloomberg Survey		133.0	133.0	133.5	134.0
Spot/Forward	134.9	134.9	134.9	134.8	134.8

Source: Bloomberg, Erste Group Research

Interest rate forecasts

	current	Dec.15	Mar.16	Jun.16	Sep.16
3M Euribor	-0.05	-0.05	-0.05	-0.05	0.00
3M Libor US	0.32	0.63	1.00	1.30	1.80
3M Libor CH	-0.73	-0.75	-0.75	-0.75	-0.75

Source: Bloomberg, Erste Group Research

Erste Group Research

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