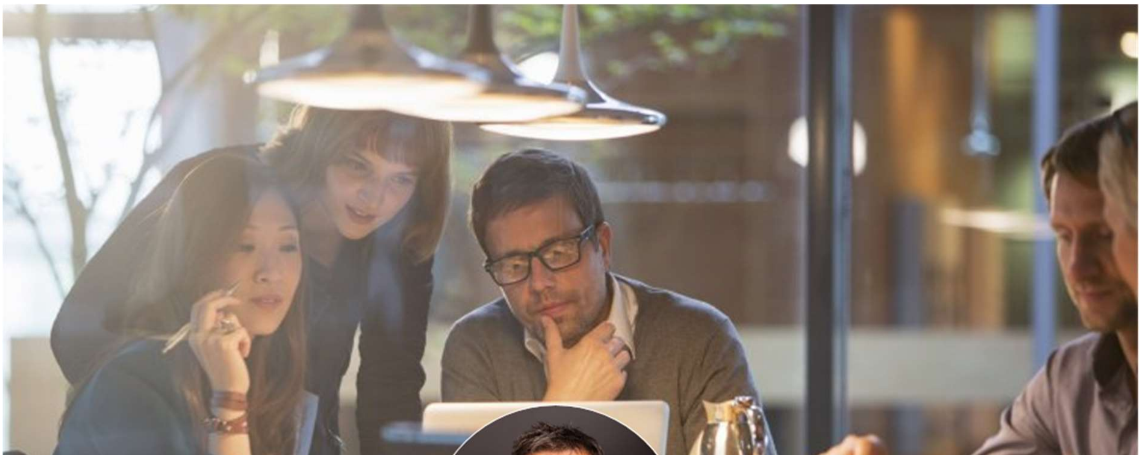
Focus FX

April 2020



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In a word:

The spread of the covid-19 epidemic led to a market collapse not seen since the Great Depression and the containment measures brought the global economy to a standstill. In the foreign exchange market, high-risk currencies experienced very large swings and, in some cases, hit historic lows, while safe-haven currencies benefited from investor panic.

Rapidly, major economic stimulus policies were put in place in the G10 countries and all monetary and fiscal policy tools are used. Renewed investor confidence led to a strong and rapid market rebound. From their lows, equity markets have retraced more than 20% of their previous losses. This easing fear has also been felt in currency markets. AUD, NZD and NOK retraced more than half of the March decline. The rebound in oil prices also fuelled the recovery. Although EURUSD volatility has decreased, the pair is still subject to large fluctuations. Indeed, although the epidemic may have peaked in Europe and the US, uncertainty will persist in the short term and the risk of a second wave regarding the virus remains high. Initial economic figures show a deep and global recession and a resumption of growth is not expected before the second half of the year. With such conditions, although we continue to see a gradual appreciation of currencies over the next 3 and 12 months, we lowered our targets for all currencies except for EURUSD where short and medium-term factors remain in favour of a stronger euro. In the short term, we revised up our targets for CHF and JPY. We expect risk sentiment to remain globally depressed over the next 3 months.

	Country	Spot		Target three months		Target twelve months	
		4/6/2020		Trend	Mid	Trend	Mid
Against euro	United States	EUR / USD	1.08	Negative	1.14	Negative	1.16
Against euro	United Kingdom	EUR / GBP	0.88	Negative	0.90	Neutral	0.88
Against euro	Switzerland	EUR / CHF	1.06	Neutral	1.06	Negative	1.12
Against euro	Japan	EUR / JPY	118	Neutral	121	Negative	123
Against euro	Norway	EUR / NOK	11.27	Positive	11.00	Positive	10.30
Against dollar	Japan	USD / JPY	109	Positive	106	Positive	106
Against dollar	Canada	USD / CAD	1.41	Positive	1.38	Positive	1.34
Against dollar	Australia	AUD / USD	0.61	Positive	0.65	Positive	0.67
Against dollar	New Zealand	NZD / USD	0.59	Positive	0.61	Positive	0.63
Against dollar	Brazil	USD / BRL	5.24	Positive	5.00	Positive	4.50
Against dollar	Russia	USD / RUB	76.2	Positive	70.0	Positive	66.0
Against dollar	India	USD / INR	76.0	Positive	74.0	Positive	72.0
Against dollar	China	USD / CNY	7.09	Neutral	7.00	Positive	6.80

Source: BNP Paribas - Bloomberg

EURUSD

The **euro** volatility reached high levels and the pair underwent extreme fluctuations. The value of one euro surged near 1.15 before breaking below 1.07 in less than 15 days. The unprecedent Fed reaction brought US rates down to historical low levels and narrowed yield differentials with German rates. Thus, given the elevated global investor exposures to the US dollar after several years of relatively attractive yields, collapsing yield differentials, and a high level of FX market volatility dampened the attractiveness of the USD carry strategy. In addition, the coordinated actions between the main G10 central banks to preserve USD liquidity should reduce the attractiveness of the US dollar. **We keep our latest target at 1.14 over the next 3 months**. Over the second semester, we should see a rebound of the Eurozone and US activities. However, monetary policy should remain accommodative for a while to sustain the economic recovery. Lower US yields relative to the EU should imply a sustainable decline in European outflows towards US fixed income assets and benefit the euro. Regarding fundamental drivers, they support a stronger euro near term. The structural overvaluation of the greenback compared to its long-term fair-value (1.31) hints at a sustainable upward trend of the EURUSD in a longer run. **Near term factors continue to lean towards an appreciation of the euro. We maintain our 12-month target at 1.16.**

EURCHF

The **Swiss franc** kept strengthening in February before broadly stabilizing in March, while the ECB announced a full support to maintain yields at low levels. However, containment measures should last until May in main European countries and IMF forecasts pointed to a deep recession over the first semester, never seen since the Great Depression. Risk-off sentiment should persist in the coming weeks and keep the EURCHF close to current levels. **We thus revised down our target to 1.06 from 1.08 over the next 3 months.** The Swiss central bank increased its foreign currency purchases in March. This underscored the SNB willingness to avoid a sharp appreciation of the Swiss currency. Peripheral spreads, an historical driver of the EURCHF, has sharply widened over the beginning of March, alongside the spread of the outbreak in Europe. The ECB's large asset purchase programme announced mid-March has eased tensions on the sovereign debt market. Peripheral spreads reacted positively, and we see further tightening over the months to come as odds of a common action from the euro area rose. The CHF remains the most attractive funding currency. We continue to see scope for investors to increasingly use the CHF as a funding currency. In addition, the structural overvaluation of the franc compared to its fair value suggests a depreciation of the CHF. **These drivers and the expected recovery of the European activity over the second part of the year should drive the EURCHF at 1.12 over the next 12 months.**

USDJPY

The volatility of the **yen** spiked in March and went back to levels reached in 2016. The safe-haven currency has been vulnerable to the rush towards USD liquidity early this month. However, the yen rallied alongside the rebound of stock markets. The narrowing of the yield differential following historical Fed actions should be beneficial for the yen near term. Moreover, the large USD exposure of Japanese investors makes the USD vulnerable. We ultimately expect Japanese institutional investor demand for the JPY to rise as the cost of hedging away USD exposure falls along with US front-end yields. Driven by these factors, **we see the JPY strengthening short term to 106 instead of 108 (previous forecast). Then, the lingering period of low yields and the uncertainty should keep the yen steady around 106 over the next 12 months.**

EURGBP

The **British pound** collapsed this year, first led by rising differences between the British government and the EU regarding Brexit negotiations and then by the coronavirus outbreak across Europe. As most of currencies, the pound volatility spiked in March and overtook levels seen in 2016. Indeed, strong government responses took long to come. Early March, the British government first adopted a herd immunity coronavirus plan while the outbreak was spreading across Europe. Simultaneously, the Bank of England undertook two unscheduled rate cuts, bringing the key rate at a record low level (0.1%). UK sovereign rates fell and hit temporarily record low levels. Later, tensions on the GBP eased as the government made a remarkable U turn and imposed a lockdown. Officials announced coordinated actions among a fiscal plan, eclipsing the financial rescue plan deployed during the GFC. The late government answer might keep the UK longer in the sanitary crisis and containment measures could linger more than in the rest of Europe. In addition, the GBP could be highly volatile over the coming weeks as Brexit headlines will come back. The deadline to request an extension of the transition period is getting closer while Prime Minister Johnson had pledged to exit the EU at the end of 2020 with or without agreement. **In this context, we do not see the GBP appreciating short term and revised our 3-month target to 0.90 from 0.85.** Near term, Brexit negotiations should drive the pound. Trade talks should have resumed in March, but they have stalled alongside the coronavirus crisis. This would leave only 9 months to UK and EU negotiators to find an agreement while both parties showed strong divergences**. The GBP volatility should persist and prevent from a strong appreciation of the cable. We keep our 12-month target at 0.88.**

AUDUSD

The **Australian Dollar** fell in March to a 17-year low before retracing nearly two-thirds of its losses. Although the number of deaths related to covid-19 is relatively low, the situation could quickly worsen as health services become more stretched. The government has just extended the containment for 4 weeks after closing the borders and some state borders in Australia. The fiscal and monetary responses were well received by the markets and led to a rebound in the Australian dollar. The government unveiled a historic stimulus package equivalent to 10% of GDP. Support will be provided to businesses to avoid massive unemployment, to households and to airlines. The government and the central bank are committed to maintain the stability of the Australian financial market in order to continue financing businesses. The central bank has lowered interest rates twice, bringing the reference rate to 0.25%. In addition to funding measures and repo operations, it launched an asset purchase program for the first time to achieve its objective of reducing the yield on 3-year government bonds to 0.25%. Although Australian and US bond yields have simultaneously declined over the last three months, the yield spread has widened and should support the AUD. **In the short term, the Australian economy should benefit from an expected rapid rebound in Chinese demand amid low yields, a weak Australian dollar and an infrastructure spending plan. We see short-term upside potential at 0.65 and revised our 12-month target to 0.67.**

NZDUSD

The **New Zealand** dollar has dropped around 10% since the beginning of the year. Like its Australian neighbour, the kiwi has been particularly hit by the collapse of Chinese demand, since China is the biggest importer of New Zealand products. Falling commodity prices following the sharp decline in global demand weighed on the NZD. The IMF expects New Zealand to experience the largest GDP contraction among Asia-Pacific countries. However, New Zealand is among the good performers in terms of managing the sanitary crisis. Indeed, the country reports less than 10 deaths and just over 1,000 covid-19 infected cases. The government has committed to providing significant financial support of more than 4% of GDP to businesses and households. For its part, the central bank has lowered key rates by 75bp to 0.25%, announced an asset purchase programme of NZD 30bn and launched a liquidity support plan for banks. Over the next 3 months, we believe that the NZD has little upside potential given the strong recovery since mid-March (+8.5%). **We are revising our target to 0.61 (value per NZD).** In the medium term, certain factors would support the kiwi. **The expected recovery in**

China, the resumption of risk appetite and a favourable interest rate differential should push the NZD towards its 200-day moving average of 0.63.

USDCAD

The **Canadian dollar** has weakened sharply against the US dollar and has lost more than 8% in 2020 so far. However, its fall remained more moderate compared to other currencies with high commodity price exposure. Like most Western countries, Canada has imposed containment measures to curb the spread of covid-19. The economic downturn has already had serious consequences, particularly on employment. In March 1 million Canadians lost their jobs, while the index reflecting sentiment in the manufacturing sector reached an all-time low. Canada's central bank was one of the first to react. On three occasions, it lowered the policy rate by 50 bps. Like the Fed, interest rates were cut by 150 bp in one month, reaching 0.25%. A CAD 200bn asset purchase program was launched, targeting government and provincial bonds as well as investment grade bonds. At the same time, the government announced a massive plan to support households and businesses, approaching 9% of GDP. In the short term, we see the CAD rebounding. Since the CAD hit a low point mid-March, the currency has corrected only slightly, depressed by the WTI, which is struggling to recover. The agreement reached between OPEC members and several oil producers, including Canada, should allow a rebound in oil prices provided that global demand picks up. **Although we expect the CAD to recover only slightly over the next three months (1.38 value for one US dollar), we are forecasting a return to the 200-day (1.34) 12-month moving average.**

EURSEK

The **Swedish krone** followed the same path than most of G10 currencies last month but to a lesser extent. Indeed, the SEK hit a trough on March 18 and got close to its historical low level (reached in 2009) but rapidly recovered and then regained 4% against the euro. Overall, the Swedish currency lost 3.6% on a year-to-date basis while the NOK collapsed by 15%. This relative resilience occurred despite Sweden remaining the only Western Europe country which adopted a collective immunity strategy so far while most of neighbours imposed a lockdown. The coronavirus toll is far more important than the average in Scandinavia. **Due to high risks of increasing death cases over the next weeks, odds that the EURSEK hovers close to current levels are strong over the next 3 months.** For its part, the government announced a series of stimulus measures including a guarantee of 70% on new loans to compagnies in extreme difficulties due to the covid-19 crisis. It also proposed more flexible conditions to receive unemployment allowances. On the monetary side, the central bank extended its bond purchase programme to SEK 300bn. It implemented new liquidity measures including a lower overnight lending rate. However, the Riksbank ruled out any rate cut to negative rate so far while it was broadly expected by markets. Such a capitulation from the central bank could be negative for the SEK. For the time being, we think that the strong position of the central bank should benefit to the yield differential. Overall, the sanitary crisis will deepen the ongoing deceleration of the Swedish economy. The Ministry of Finance forecasts a contraction of 4% of the economic growth in 2020. However, this is in line with our expectations for the Eurozone (-4.3%). **We see the Swedish currency**

appreciating, going back to its 200-day moving average over the next 12 months (10.7), alongside the regain of risk appetite.

EURNOK

The **Norwegian krone** collapsed, falling by almost 15% since the beginning of the year, the worst performance among the G10 countries. The currency reached an all-time low mid-March, coinciding with the collapse of equity markets and oil prices. Since then, the NOK has regained some ground against the euro as volatility has declined and equity markets have recovered. Nevertheless, the NOK remains at very low levels today. Although a historic agreement between OPEC members and its allies has been reached, oil prices remain at historically low levels. The price recovery will be slow and the fall in Norwegian oil exports will weigh heavily on GDP. The government is providing bank loan guarantees for the most affected companies as well as a business support plan. On the one hand, the monetary authority lowered the reference interest rate twice (-150 bp) bringing it to 0.25%, an all-time low. On the other hand, it provided a liquidity facility for commercial banks. Although the Norwegian economy showed some signs of slowing before the health crisis, the fundamentals remained strong. The country had one of the strongest growth forecasts in the euro area, unemployment was fluctuating at a low level and policy rates were among the highest in the G10. This favourable situation, coupled with one of the lowest numbers of covid-19-related deaths in Western Europe, should allow the Norwegian economy to rebound. Moreover, the government is planning a gradual exit of the lockdown as of 20 April, making Norway one of the first European countries to start a recovery of its economy. We still expect the NOK to appreciate, but less than before. **Although in the short term we see the NOK appreciating weakly to 11.0 in an environment where risk aversion will persist, the NOK is expected to strengthen further to 10.30 over the next 12 months.**

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