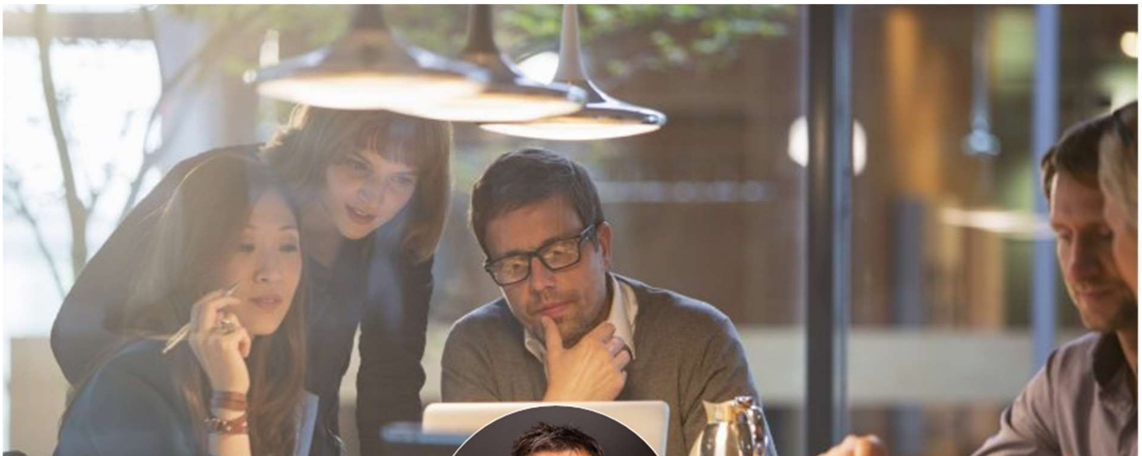
Focus FX

June 11, 2020



Guy ERTZ
Chief Investment Advisor

In a word:

In May, the strong investors' optimism kept supporting the FX market. The risk-on mood since mid-May, and G10 currencies sharply rallied, in particular commodity currencies at the expenses of the greenback and safe haven currencies. Recent economic releases surprised to the upside and markets expect a faster recovery in Europe and the US than previously anticipated. However, we keep our base case scenario of a stabilization period this summer before a global economic recovery. This current optimism seems to shrug off renewed geopolitical tensions, especially between the US and China.

The last three weeks witnessed a strong rally on the FX market. The euro recovered to its 3-month high. First, the euro rally was triggered by rising hope of an agreement among the EU countries on the recovery fund following the Franco-German proposal. Since then, while a critical EU meeting will be held June 19, the positive market sentiment continued to fuel the euro well beyond its 200-days moving average. Meanwhile, the DXY (USD index) slid by more than -3.5% while investors were stepping back from safe haven assets (the CHF fell by -3.4% and the JPY was down -2.0%). Brexit headlines came back to the forefront as the fourth round of negotiations held early June. Markets do not expect a significant breakthrough over the high-level meeting at the end of the month as divergences remain on key topics. Amidst a still locked down economy, Brexit headlines should remain a driver of the GBP. Commodity currencies, the AUD, the NZD, the NOK and to a lesser extent the CAD spiked. The AUD and the NZD took advantage from faster-than-expected signs of the Chinese recovery. The NOK benefitted from the historical rebound of oil prices and the upward GDP growth revision. The SEK outperformed this year, as the krone is the only currency to record a positive performance against the euro. The fact that the policy rate did not become negative was one of the main supportive drivers.

Overall, the recent surge on the FX market pushed high-risk currencies beyond their 3-month target, and three of them even broke their 12-month target. We keep thinking that markets remain overly optimistic, shrug off rising tensions between the US and China and underestimate the sharp economic downturn that economies will face this year. We thus maintain our view of a global correction over the next 3 months while safe haven currencies should strengthen. Over the next 12 months, we continue to forecast a global appreciation of G10 currencies compared to their 3-month level (except for the CHF and the JPY), alongside a weakening of the USD.

	Country	Currency	Target three months		Target twelve months	
			Trend	Mid	Trend	Mid
Againt euro	United States	EUR/USD	Negative	1,12	Negative	1,16
	United Kingdom	EUR/GBP	Negative	0,90	Neutral	0,88
	Switzerland	EUR/CHF	Negative	1,06	Negative	1,09
	Japan	EUR/JPY	Negative	121	Negative	123
	Norway	EUR/NOK	Positive	11,00	Positive	10,30
	Sweden	EUR/SEK	Negative	10,70	Negative	10,70
	Canada	EUR/CAD	Negative	1,55	Negative	1,55
	Australia	EUR/AUD	Negative	1,72	Negative	1,73
	New Zealand	EUR/NZD	Negative	1,84	Negative	1,84
	Brazil	EUR/BRL	Positive	5,60	Positive	5,22
	Mexico	EUR/MXN	Positive	24,64	Positive	23,20
	China	EUR/CNY	Negative	7,84	Negative	7,89
Against dollar	Japan	USD/JPY	Neutral	106	Neutral	106
	United Kingdom	GBP/USD	Negative	1,27	Negative	1,32
	Canada	USD/CAD	Positive	1,38	Positive	1,34
	Australia	AUD/USD	Positive	0,65	Positive	0,67
	New Zealand	NZD/USD	Positive	0,61	Positive	0,63
	Brazil	USD/BRL	Positive	5,00	Positive	4,50
	Mexico	USD/MXN	Positive	22	Positive	20
	Russia	USD/RUB	Positive	70	Positive	66
	South Africa	USD/ZAR	Positive	17,50	Positive	16,50
	Turkey	USD/TRY	Positive	6,80	Negative	7,00
	India	USD/INR	Positive	74,00	Positive	72,00
	China	USD/CNY	Positive	7,00	Positive	6,80
	South Korea	USD/KRW	Positive	1200	Positive	1170
	Singapore	USD/SGD	Negative	1,45	Positive	1,40
	Malaysia	USD/MYR	Negative	4,35	Positive	4,30
	United States	DXY	Negative	97,3	Negative	94,5

Source: BNP Paribas WM

EURUSD

The **euro** picked up after the announcement of a breakthrough on the European financing needs. The Franco-German proposal on a European recovery fund larger than markets expected temporarily eased investor's concerns. Moreover, the reopening of European economies, the absence of a resurgence of the virus so far fuelled market optimism. Widespread riots in several American cities also put the USD under pressure. However, the European recovery fund could take longer to agree as divergence persists among the 27. In case of no agreement on the mid-June EU leaders' meeting, this could dampen the expected euro rally short term. We maintain that the USD will remain supported by lingering uncertainty this summer. The possible regain of trade tensions between the US and China could be a trigger for higher risk aversion. **The euro is currently overbought. We thus adjusted our 3-month target to 1.12 (from 1.14).** Near term, we keep our conviction of a weaker dollar. Fundamental drivers remain in favor of the euro. The yield differential sharply contracted since the beginning of the year following the unprecedented Fed's action. Once the risk aversion will ease alongside the global economic recovery, this factor should weigh on the dollar. Combined to the aggressive fall in yields, the government fiscal support will worsen the fiscal deficit and would be negative for the USD. The structural overvaluation of the greenback compared to its fair-value (1.31) also hints at a sustainable upward trend of the EURUSD in a longer run. **We maintain our 12-month target at 1.16.**

EURCHF

The **EURCHF** was hovering steadily below 1.06 in May while the Franco-German proposal led to a sharp rally of the euro against the CHF. In addition, the rising appetite for risk assets weighed on the safe-haven currency. Markets seem to have priced an agreement of the EU members on the recovery fund proposal likely over the EU summit mid-June. The approval process of the recovery fund could however take longer, which should weigh on the euro. In addition, tensions between the US and China spiked recently and further strains could lead to a renewed risk-off sentiment. As the franc is currently overbought, **we keep our EURCHF around 1.06 over the next 3 months**. Near term, we think narrowing peripheral spreads will be key drivers of a weaker Swiss franc. We expect spreads to keep shrinking over the coming months. However, we see a more limited upside for the euro. A final EU agreement should be not enough to drive the euro 5% higher compared to its 3-month target. Moreover, the Swiss central bank intervention to stem the CHF appreciation reached record high levels last week without producing significant impact on the franc. **We thus revised down our 12-month target to 1.09 instead of 1.12.**

USDJPY

The **Japanese yen** slightly weakened in May before falling -1.6% the first week of June alongside the wave of risk-on. Equity markets continue to progress, the MSCI broke its 200-DMA fueled by economic reopening, signs of a faster recovery suggested by latest economic data and expectations for further stimulus. The strong improvement of the global market sentiment led the yen decline as investors' interest has shifted to risk assets from safe haven currencies. Domestically, the Prime Minister unveiled a second financial package adding to the world's biggest stimulus (40% of the GDP). The lift of the nationwide state of emergency should benefit to the pro-cyclical Japanese stock market. However, the global market optimism could be overstated. Downside risks linger and should support the JPY short-term. Renewed US-China tensions following recent demonstrations, risk of a second wave of the virus and downward revisions of economic forecasts cannot be ruled out. **We keep our view of a stronger JPY over the next 3 months (USDJPY target at 106).** Near term, we see the weakening of the greenback offsetting the rising appetite for risk assets alongside the global economic recovery by the end of the year. Risk-on sentiment should weigh on yen demand, **but the weakening of the USD would keep the USDJPY steady over the next 12 months around 106.**

EURGBP

The **British pound** fell in May and lost 3.5%. Brexit headlines are back in the forefront. The fourth round of UK-EU negotiations is held the first week of June. So far, deadlock remains on several hot topics. The clock is ticking and the deadline to extend the transition period over the high-level meeting in June is coming closer while expectations of a breakthrough remain low. As market sensitivity to Brexit newsflow rose, this should fuel GBP volatility over the coming weeks. **We keep our 3-month target at 0.90 (value for 1 euro).** Near term, the expected rebound of the global economic recovery will support a risk-on mode that should be beneficial to the pound. However, the upside should be limited. The UK has just announced a reduction of restriction measures while main European countries lifted it. This could weigh on the speed of UK economic recovery compared to its neighbors. Moreover, the strong BoE intervention drove the UK yield curve down. Rate differentials with German interest rates shrank since the beginning of the year. **For these reasons, we keep our 12-month target unchanged at 0.88.**

AUDUSD

The rally of the **Australian dollar** speeded up in May as the currency outperformed its peers and gained near 7% to this day. The aussie took profit from the surge in market confidence that fuelled the recovery of global stock markets since 2 months. The latest Chinese PMI pointed to a strong improvement of sentiment, beyond expectation. These have been positive drivers of the aussie. At the latest central bank meeting, interest rates remained unchanged, just above zero and are expected to remain on hold for the foreseeable future. The central bank reiterated that Australia will enter in a deep recession but that it is “possible that the depth of the downturn will be less than earlier expected”. However, we think that the current market optimism could shrug off downside risks. The recent renewed tensions between the US and China could trigger a wave of risk-off. A second wave of the virus cannot be excluded yet and the current AUDUSD level does not seem to reflect the strong expected economic downturn. The AUD is currently overbought. **We thus see the AUDUSD going back below its 200-day moving average, around 0.65 over the next 3 months since uncertainty lingers**. Near term, global economic recovery and in particular the resumption of the Chinese activity coupled with an expected upward trend of iron ore prices should be key for the aussie. **We keep our view of an AUDUSD trading around 0.67 over the next 12 months.**

NZDUSD

The **New Zealand dollar** also strengthened along with the recent market rally while the greenback lost steam. The kiwi surged near 10% over the last 3 weeks and broke its 200-days moving average. Beside the regain of appetite for commodity currencies, the latest newsflow on the sanitary situation in New Zealand has been very encouraging. The country did not record new covid cases over the last 2 weeks. However, while the central bank forecasts a deep GDP contraction of near 10% this year, the monetary authority doubled its quantitative easing over its last meeting in May and did not rule out further cuts if necessary. This could bring the policy rate in negative territory. Until now, the yield differential with the US was in favour of the NZD. An increase of tensions between the US and China could severely dampen the positive sentiment towards risky assets. Short term, we see the market optimism fading somewhat alongside downside risks. Moreover, the NZD is overbought today. We expect a reversal of the current upward trend towards our 3-month target at 0.61. **We think that the global recovery and the weakening of the USD will push the NZDUSD towards 0.63 over the next 12 months**.

USDCAD

The **Canadian dollar** rose over the four past weeks, even though it did not surge as much as the aussie and the kiwi which were supported by positive Chinese data. Rising appetite combined with US crude oil prices soaring more than 60% in a month helped the CAD to quickly recover from very depressed levels. Over the last monetary meeting, the newly appointed governor left interest unchanged at 0.25% and underscored that an additional rate cut was not under consideration. He also scaled back asset purchase operations while expects a contraction in Q2 which would be less deep than previously anticipated. We think that downside risks should overshadow market optimism over the weeks to come. **In this context, we see the USDCAD falling back to 1.38 (value for 1 US dollar)** short-term. **Over the next 12 months, thanks to the economic recovery awaited in the last part of the year, rising oil prices and our conviction of a weakening US dollar, we think the CAD has more upside potential to 1.34.**

EURSEK

The **Swedish krone** continued to steadily strengthen since reaching a low mid-March. The SEK was up 1.10% on a year-to-date basis. While the strong rise in investors' confidence drove the global recovery for some currencies, the SEK has been supported by an unexpected resilience of the policy rate. Indeed, the governor has kept the key rate unchanged while markets were expecting the central bank to bring back interest rates in negative territory. Markets seem to shrug off the anticipated deep economic downturn (-10%) announced by the central bank which suggests that Sweden would not have associated gains to its covid-19 approach. The country recorded a much higher death toll than its Nordic neighbours and has one of the highest death rates per capita from the coronavirus. While neighbours are due to lift border restriction measures with European countries, they keep their borders closed with Sweden. The small Nordic economy remained largely reliable to its external sector and strongly depends on the European demand. We are convinced that markets still ignored downside domestic risks. In this context and considering that the krone is very close to overbought levels. **We keep thinking that the EURSEK will hover around 10.70, over the next 3 and 12 months.**

EURNOK

The **Norwegian krone** kept strengthening in May and in particular over the first week of June. The regain of investor's appetite for risk assets fuelled by market optimism has been a strong catalyst. Beside, the historical surge in oil prices supported the NOK. The sanitary situation remains under control in the country, which has been one of the first to lift restriction measures. National Statistics recently released more optimist projections. While they forecasted a contraction of the GDP (excluded the oil sector) of -5.5% this year, they revised up their expectations and see a contraction less important than before of -3.9%. The strong coordinated action from the central bank and the government will help to reduce the amplitude of the downturn. The economic trough should have been reached in April. However, as for commodity currencies, we think that the surge of the NOK could be overstated. The current market sentiment seems to be uncorrelated to economic and social damages that economies will have to face. The krone is currently overbought. **In a context of persistent downside risks, we forecast that the NOK will stabilize between its 50 and 200-days moving average, around 11.0 over the next 3 months.** Near term, we keep convinced that the improving market sentiment will support the NOK upside along with our positive view on oil prices. **We keep our 12-month target at 10.30.**

THE INVESTMENT STRATEGY TEAM

France

Florent BRONES
Chief Investment Officer

Asia

Prashant BHAYANI
Chief Investment Officer, Asia

Grace TAM
Chief Investment Advisor, Asia

Belgium

Philippe GIJSELS
Chief Investment Advisor

Xavier TIMMERMANS
Senior Investment Strategy, PRB

Alain GERARD
Senior Investment Advisor, Equities

Pol TANSENS
Head of Real Estate Strategy

Luxembourg

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

Switzerland

Roger KELLER
Chief Investment Officer

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