

# FX Essentials

## EUR – a floor and a failed recovery

Relative rates have proved a rather poor explanatory factor for moves in a range of currency pairs during the reign of unconventional monetary policy. **An alternative gauge of FX-relevant flows to rates, if more medium term in nature, is the broad basic balance of payments (BBoP), which arguably captures the commercial demand for a currency.** Recall that a country's BBoP equals the sum of the current-account balance, net portfolio investment and direct investment, where the first arguably catches currency demand deriving from trade in goods/services and the latter two foreign investment demand.

**What does the euro-zone BBoP (see chart) tell us about EUR?** Significant capital outflows that took place in the aftermath of negative rates and QE caused, not least, by foreign divestment in EUR debt instruments in a search for yield outside the euro zone. To the extent that at least part of this flow was unhedged – as anecdotal evidence suggests it was for reserve managers who could not lock in negative rates – this arguably weighed on EUR. But, the capital flight has now faded and as a decent euro-zone current-account surplus remains, yet without dragging the (here: effective) EUR along too much.


**Why then has EUR failed to recover?** We see at least two reasons. First, the euro-zone economy remains challenged on both a cyclical and structural level. A turn in the Chinese cycle and fading trade tensions may alleviate the short-term pain but structural growth headwinds (ageing populations, fiscal restraint, etc.) remain. Second - and relatedly - the status of the EUR as a funding currency is not set to be confronted with limited scope for ECB 'normalisation'. Indeed, the *non-commercial* (read: speculative) demand for a currency as evident from the weekly CFTC COT data (latest *here*) show that investors still favour USD positions over most G10 currencies due to the still significant carry. The Fed nor the ECB will change that any time soon.

For EUR/USD, this means that the cross will be stuck in undervalued territory for longer, as there is no obvious trigger to fuel a correction and we now have 1.13 as 12M target, see latest *FX Forecast Update*. **Will we see a more sustained break below 1.10 near term? It would certainly require renewed flaring up of political risks and/or pricing out a Fed cut but 1.08 should provide a strong floor even in that environment.**

### Views for the short term

- **EUR/NOK** - stay short but consider taking some chips of the table following the latest NOK rally.
- **EUR/SEK** - in absence of macro drivers, changes in risk sentiment will probably dominate the cross this week.
- **EUR/USD** - to drift towards 1.09 short-term as Fed is done cutting for now.
- **EUR/GBP** - near term, 0.85-0.875 is the likely range. Note, UK data surprises are coming in worse than European.
- **USD/JPY** - US yields, risk sentiment and commodity prices have supported the cross towards 109. Much more muted impact in EUR/JPY.
- **EUR/CHF** - higher lows as tail risks taken out but downside risks remain as Swiss deflation risks set to linger.
- **Oil** - range-bound in mid 60s (Brent) after easing of trade tensions; upside geopolitical risks remain.

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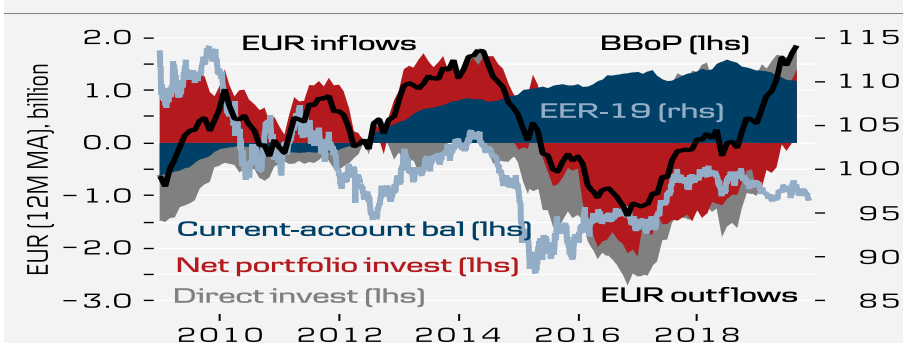
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Euro-zone BBoP advance has failed to drag EUR along as ECB easing bias still reigns



Note: Past performance is not a reliable indicator of current or future results

Source: Bloomberg, Macrobond Financial, Danske Bank

On the radar this week

Global FX	ISO	Market mover	Potential FX impact (X = limited, XX=some, XXX=essential!)
Tue 19-Nov	HUF	Central Bank of Hungary rate decision	X
	USD	FOMC minutes from October meeting	X
	EUR	ECB minutes from October meeting	X
Thurs 21-Nov	EUR	Consumer confidence	X
	EUR	PMIs (JP, EZ, US, GB)	XXX
<b>Scandi FX</b>			
Tue 19-Nov	SEK	New dwellings and construction	X
Wed 20-Nov	SEK	Riksbank publishes financial stability report	X
Fri 22-Nov	NOK	SSB oil investment survey	XXX
	SEK	Two Riksbank speeches, Ohlsson (Hawk) and Jansson (dove)	XX

FX options

Both EM and G10 GX vols have generally traded sideways over the last week. 1M GBP vols have soared as the general election is now captured by the 1M tenor. EUR/USD vols generally still appear cheap for tenors beyond 2W.

Currency pairs	2W			1M			3M		
	Overall valuation	Implied vol	Realised vol	Overall valuation	Implied vol	Realised vol	Overall valuation	Implied vol	Realised vol
EUR/NOK	Neutral	6.2%	5.6%	Neutral	6.4%	6.0%	Neutral	6.4%	6.3%
EUR/SEK	Neutral	5.2%	5.0%	Neutral	5.4%	5.4%	Neutral	5.5%	6.1%
EUR/USD	Neutral	4.1%	3.6%	Cheap	4.9%	4.3%	Cheap	4.8%	5.0%
EUR/GBP	Neutral	6.0%	5.1%	Cheap	10.9%	6.3%	Neutral	8.8%	8.2%
USD/JPY	Cheap	4.6%	4.2%	Neutral	5.5%	4.0%	Cheap	5.9%	5.5%
USD/NOK	Neutral	7.7%	7.0%	Neutral	8.1%	7.6%	Neutral	7.8%	7.7%

Note: Past performance is not a reliable indicator of current or future results  
Source: Bloomberg, Danske Bank

IMM positioning

JPY positioning still neutral despite consistent bearish builds. For latest, see IMM Positioning Update.

Currency	Level			Abs. position	Positioning trend
	Stretched short	Neutral	Stretched long		
EUR	█	█	█	Short	↔
JPY	█	█	█	Short	↓
GBP	█	█	█	Short	↑
CHF	█	█	█	Short	↔
CAD	█	█	█	Long	↔
AUD	█	█	█	Short	↔
NZD	█	█	█	Short	↔
MXN	█	█	█	Long	↔
BRL	█	█	█	Short	↔
RUB	█	█	█	Long	↔
USD*	█	█	█	Long	↔

16 percentile      84 percentile  
\*Adjusted according to USD value of contracts  
█ Latest      █ Second latest

Note that percentiles are not based on any distributional assumption.  
Positioning trend is defined as follows:  
• Two/three consecutive weekly changes in positioning (% of open interest) of the same sign: ↔ or ↕  
• Four or more consecutive weekly changes in positioning (% of open interest) of the same sign: ↓ or ↑  
\*\* Over a two-year period

Note: Past performance is not a reliable indicator of current or future results  
Source: Commodity Futures Trading Commission, Danske Bank

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Short-term financial models

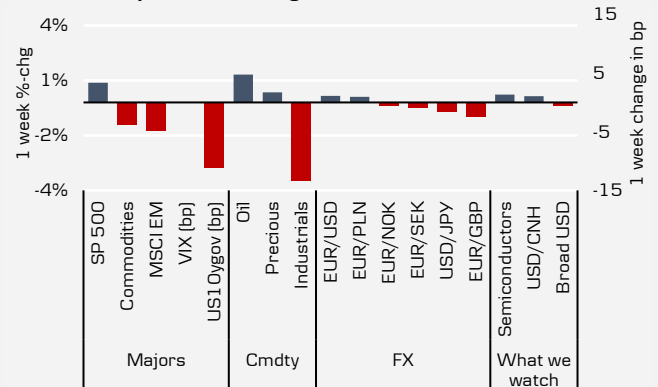
According to our short-term financial models the NOK is no longer as oversold as previously even if a gap remains to both EUR, USD and SEK. EUR/USD remains close to the models' fair-value estimate while GBP remains in overbought territory.

	Spot	Model	Signal	Deviation (%)	Deviation (stddev)	Model Strength
Standa	EUR/NOK	10.036	9.9016	1.4%	0.9	█
	EUR/SEK	10.650	10.5835	0.6%	-0.2	█
	USD/NOK	9.072	8.9636	1.2%	0.6	█
	EUR/SEK	9.628	9.5617	0.7%	0.0	█
Majors	EUR/USD	1.061	1.0691	Oversold	-0.7%	█
	EUR/USD	1.106	1.1126		-0.6%	█
	EUR/GBP	0.854	0.8772	Oversold	-2.6%	█
	EUR/CHF	1.095	1.1036		-0.8%	█
Commodity	GBP/USD	1.295	1.2894	Overbought	2.0%	█
	AUD/USD	0.682	0.6959		-2.0%	█
	NZD/USD	0.641	0.6641	Oversold	-3.6%	█
	USD/CAD	1.321	1.3143		0.5%	█
AUD/NZD	1.064	1.0516		1.2%	█	

Note: Past performance is not a reliable indicator of current or future results  
Source: Macrobond Financial, Danske Bank

Cross-asset moves last week

Industrials and yields are coming down. VIX sidelined.



Source: Macrobond Financial, Danske Bank. Note: time period evaluated is Friday to Friday. Commodities are Bloomberg indices. Broad USD is Bloomberg dollar index. Semi-conductors refer to Philadelphia Stock Exchange index. Past performance is not a reliable indicator of current or future results. Note that it is not possible to invest directly in an index.

Links to recent FX-relevant research

- FX Forecast Update: Northern stars twinkling - but it may not last
- FOMC Call Update - Fed on hold for now but may be forced to cut again
- Reading the Markets Sweden - 15 November 2019
- Reading the Markets Norway - 18 November 2019

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