

# FX Strategy

## FX Strategy: MEVA 'justifying' weaker dollar policy

- The Danske G10 Medium-term Valuation (MEVA) model continues to point to significant upside in EUR/USD with fundamentals now pinning the cross as high as 1.31. Thus 'gravity' remains for a renewed move higher in the cross.
- The EUR/SEK estimate also moves higher still, now standing at 9.95. This 'high' fundamental level is one argument as to why downside in the pair should be limited in 2019.

Since our spring update, see *FX Strategy: Trump in MEVA space: US isolation puts USD at risk*, 14 March 2018, a few notable shifts have taken place in the Danske G10 Medium-term Valuation (MEVA) model estimates for notably EUR/USD and EUR/SEK; see full set of estimates in table below and in charts overleaf.

**MEVA continues to point to significant upside in EUR/USD with fundamentals now pinning the cross at 1.31** (previously 1.28). This implies that 'gravity' remains for a renewed move higher in the cross over the 'medium term'. The cause of the continued move higher in the EUR/USD estimate is a combination of both model factors as the productivity-differential and the terms-of-trade component alike have moved in favour of EUR vs USD lately. **We still see the key trigger for a fundamental correction to be initiated being the ECB closing in on the first rate hike.** But, we also note that should the Trump administration invoke more explicitly on a 'weak dollar' policy e.g. using FX intervention as part of the trade war, a move higher in EUR/USD could happen very swiftly given the distinct fundamental misalignment of the two currencies.

**Further, the EUR/SEK estimate continues to move higher to now stand at 9.95** (previously 9.65). Again, it is both model components that have been upping the fundamental value recently. Relative to PPP estimates for the cross (our PPP model points to 8.42), the MEVA estimate is thus rather 'high'. This adds another argument – beyond a hesitant-to-hike Riksbank – as to why downside in the pair should be limited in 2019.

Finally, while Brexit leaves GBP fundamental estimates flawed with uncertainty, we note that medium-term fundamentals have moved in favour of GBP relative to USD lately with the MEVA estimate for GBP/USD now at 1.74; cable indeed stands for the biggest misalignment in the model. **Our 'Brexit-corrected' estimate of EUR/GBP is 0.82**, and we indeed expect a significant correction lower in the pair, removing the current 'no-deal' risk premium, once a Brexit deal is eventually agreed upon.

### Danske G10 MEVA model

- The Danske G10 MEVA model is a quantitative framework for bridging the short and the long term in the FX market by providing 'valuation anchors' for majors.
- MEVA falls in the class of behavioural exchange-rate models and is based on a panel-co-integration model using a measure of terms of trade and a productivity-differential measure (aka Balassa-Samuelson effect).
- Given that MEVA has a half-life of around two years (i.e. less than most PPP models), we suggest using the signals as input for 1-3Y forecasts and hedging decisions.
- For a thorough Introduction to MEVA see *FX Edge: Introducing the Danske G10 MEVA model* (1 October 2015).

#### Chief Analyst

Christin Tuxen  
tux@danskebank.dk  
+45 45 13 78 6

### Overview of Danske G10 MEdium-term VALuation (MEVA) estimates

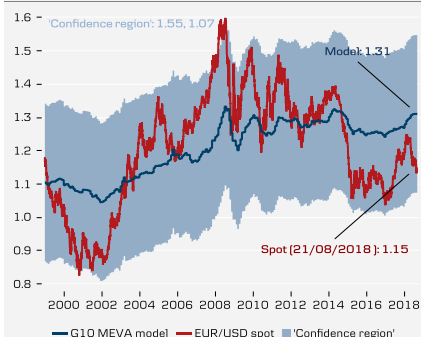
	Spot 22/08/2018	STFM estimate		Medium-term Valuation (MEVA) model				PPP estimate
			previous (Mar-18)	estimate current (Aug-18)	correction potential (% rel to spot)	lower level of 'confidence'	upper level of 'confidence'	
EUR/USD	1.16	1.15	1.28	1.31	13.4	1.07	1.55	1.29
EUR/NOK*	9.71	9.54	10.31	9.78	0.7	8.01	11.54	8.53
EUR/SEK	10.52	10.25	9.64	9.95	-5.4	9.32	10.59	8.42
USD/JPY	110	111	105	104	-5.9	76	132	80
GBP/USD**	1.29	1.30	1.70	1.74	35.2	1.37	2.11	1.66
EUR/CHF	1.14	1.15	1.27	1.27	11.6	1.05	1.50	1.27
AUD/USD	0.73	0.74	0.78	0.80	8.6	0.69	0.91	0.73
NZD/USD	0.67	0.68	0.69	0.73	8.6	0.60	0.85	0.65
USD/CAD	1.30	1.29	1.18	1.16	-11.0	1.02	1.30	1.20

\*While part of the G10 framework we advise great caution in using the MEVA estimates for the NOK. \*\*Valuation measures presented here are NOT 'Brexit' corrected. Note: STFM = Short-Term Financial Model, MEVA = Medium-term Valuation model.

Source: Eviews, Bloomberg, Danske Bank.

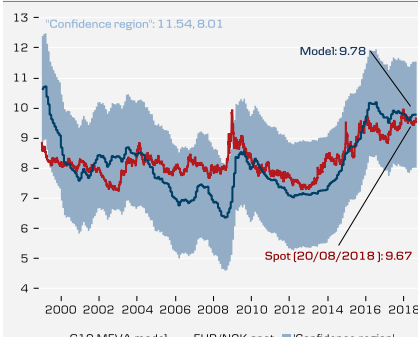
## Graphical overview of the Danske G10 MEVA model estimates

### EUR/USD back in markedly undervalued territory



Source: Eviews, Macrobond, Danske Bank.

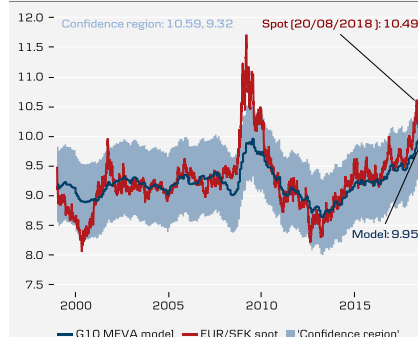
### EUR/NOK close to model estimate (in contrast with PPP signal)



Source: Eviews, Macrobond, Danske Bank

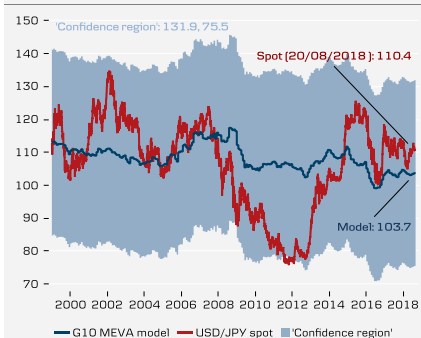
Note: we generally advise caution in using the MEVA estimates for EUR/NOK.

### EUR/SEK elevated relative to model (but much less so than relative to PPP)



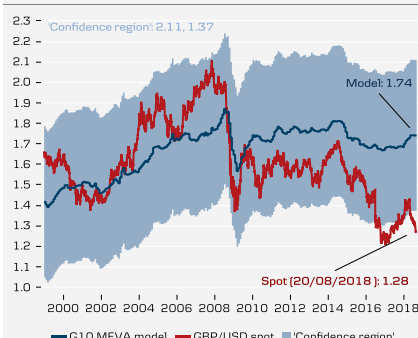
Source: Eviews, Macrobond, Danske Bank

### USD/JPY moving away from 'fundamentals' again



Source: Eviews, Macrobond, Danske Bank

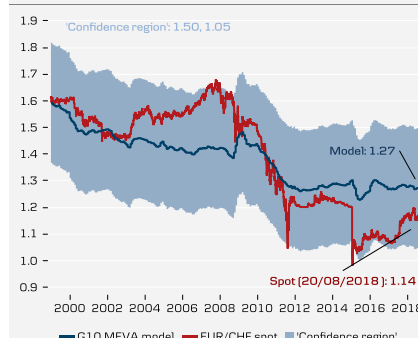
### GBP/USD significantly below estimate (but here not 'Brexit-corrected')



Source: Eviews, Macrobond, Danske Bank

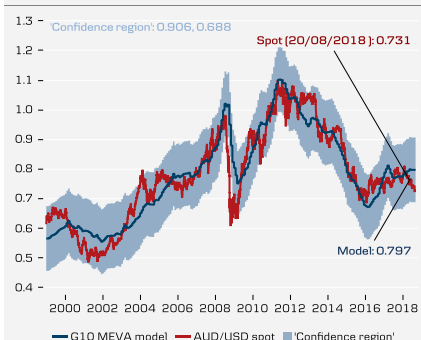
Note: estimate presented here is NOT 'Brexit-corrected'.

### EUR/CHF still lingering in undervalued territory



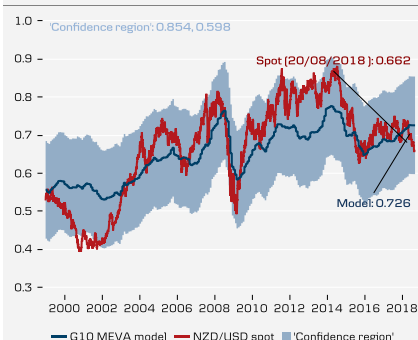
Source: Eviews, Macrobond, Danske Bank

### AUD/USD fundamentals have stabilised but cross moving away



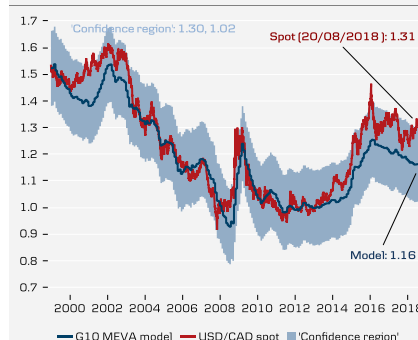
Source: Eviews, Macrobond, Danske Bank

### NZD/USD now slightly below MEVA estimate



Source: Eviews, Macrobond, Danske Bank

### USD/CAD in overvalued territory as spot and model move apart



Source: Eviews, Macrobond, Danske Bank

## Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Christin Kyrme Tuxen, Chief Analyst.

### Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

### Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

### Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

### Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

### Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

### Expected updates

None.

### Date of first publication

See the front page of this research report for the date of first publication.

## General disclaimer

This research report has been prepared by Danske Bank (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided herein.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

## Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/A, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

**Report completed:** 22 August 2018, 23:30 CEST

**Report first disseminated:** 23 August 2018, 07:00 CEST