FX Watch

Group Economics
Macro & Financial Markets Research

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Less positive on European FX

Georgette Boele
Co-ordinator FX & Precious Metals Strategy
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

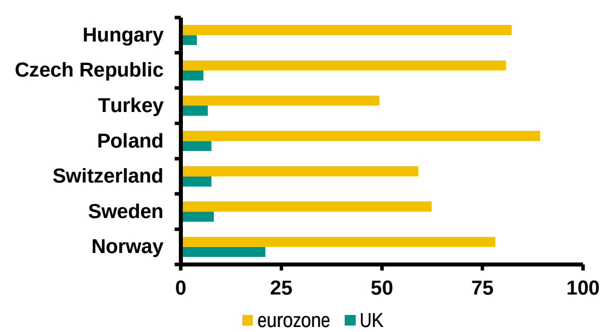
- **The Brexit result will impact European currencies …**
- **…via the trade channel and financial markets channel**
- **Weaker exports and lower growth will weigh on European FX**
- **Meanwhile central banks will remain accommodative…**
- **…which has a downward pressure on the currency…**
- **…but also supports investor sentiment**
- **In general we have lowered our European FX forecasts**

Introduction

Since the result of the Brexit referendum, sterling has dropped by more than 10% versus the US dollar, to levels below 1.33. EUR/GBP has also rallied sharply, to around 0.84. We expect sterling – and to a lesser extent the euro – to be weaker than in our pre-Brexit scenario. In particular, sterling looks likely to fall further – to a low of 1.20 against the dollar – given the risks related to the UK's huge current account deficit and the capital flows necessary to fund it as well as in anticipation of weaker UK economic growth and BoE monetary policy easing. Our base case sees lower economic growth, especially in the UK, where the uncertainty and hence corporate retrenchment will be more severe than in the rest of Europe. These effects will also impact the eurozone economy. In this FX Watch we examine these effects on European currencies: Norwegian krone, Swedish krona, Swiss franc, Polish zloty, Hungarian forint, Czech Koruna, Turkish lira.

Exports to UK and eurozone

% of total exports



Source: Thomson Reuters Datastream, IMF DOTS

Weakness in exports to weigh on European currencies…

Brexit can impact European currencies via two different channells. First, we investigate the effects via the trade channel. Second, we focus on the impact of Brexit via financial markets. Overall, the exposure to the UK via the trade channel is relatively small except for Norway. The UK accounts for 20% of Norway's total exports. However, the majority of these exports are commodities such as energy. In general, demand for energy is quite inelastic. What is more, our base case is that a Brexit will also have a modest negative impact on the eurozone economy. This will have a more substantial impact on European countries as they are highly dependent on exports to the eurozone. So the slowdown in eurozone growth will have a direct impact on exports from these countries to the eurozone. This will also weigh on economic growth. We have adjusted economic growth for most of these countries downwards. Therefore, the outlook of European currencies will deteriorate.

…and central banks to remain accommodative

Central banks of most of these European countries will likely continue to ease monetary policy or at least be accommodative. The Swiss National Bank and the Riksbank will keep monetary policy loose in order to dampen the upside in the currency and to support the economy. We expect that the central bank of the Czech Republic will keep its floor in EUR/CZK in place for longer. For Norway and the krone the situation is slightly different. To begin with, the krone moves closely in tandem with the oil price as higher oil prices improve the outlook for the economy. Secondly, we don't expect further easing by the central bank despite weaker eurozone and UK growth weighing on the Norwegian economy. We do expect that the Norges bank will merely wait a bit longer before hiking interest rates next year.

Investor sentiment should also give some support

The days following the Brexit referendum result, investor sentiment on financial markets deteriorated sharply. Since then, financial markets have become more constructive. The slide in sterling came to a standstill. In addition, financial markets have anticipated more accommodative central banks, including the pricing out of Fed rate hikes for 2016 and most of 2017. This has supported investor sentiment. Although UK political and economic uncertainty will remain, we don't expect a sharp deterioration in sentiment in global financial markets. This will support currencies of countries that are more cyclical in nature (leveraged to global economy or leveraged via commodity exposure). Except for Swiss franc (local safe haven currency) and the Turkish lira, the currencies we cover in this FX Watch are more cyclical in nature. To reflect all the above, we have adjusted our European FX forecasts.

Our European FX forecast

Changes in red/bold

	04-Jul	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
EUR/USD	1.1108	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**
GBP/USD	1.3254	**1.27**	**1.20**	**1.20**	**1.25**	**1.30**	**1.35**
EUR/GBP	0.8380	**0.87**	**0.92**	**0.92**	**0.88**	**0.85**	**0.81**
USD/CHF	0.9754	**0.98**	**0.99**	**1.00**	**1.00**	**1.01**	**1.02**
EUR/CHF	1.0835	**1.08**	**1.09**	**1.10**	**1.10**	**1.11**	**1.12**
USD/SEK	8.4648	**8.64**	**8.64**	**8.64**	**8.64**	**8.41**	**8.18**
EUR/SEK	9.4023	**9.50**	**9.50**	**9.50**	**9.50**	**9.25**	**9.00**
EUR/NOK	9.2685	**9.40**	**9.25**	**9.00**	**9.00**	**8.75**	**8.50**
USD/NOK	8.3444	**8.55**	**8.41**	**8.18**	**8.18**	**7.95**	**7.73**
EUR/DKK	7.4410	**7.46**	**7.46**	**7.46**	**7.46**	**7.46**	**7.46**
USD/TRY	2.90	**2.95**	**3.00**	**3.05**	**3.10**	**3.00**	**2.90**
EUR/PLN	4.43	**4.40**	**4.45**	**4.50**	**4.50**	**4.40**	**4.30**
EUR/CZK	27.09	**27.10**	**27.15**	**27.20**	**27.25**	**27.00**	**26.50**
EUR/HUF	316.75	**320.00**	**320.00**	**320.00**	**320.00**	**310.00**	**300.00**

Source: ABN AMRO Group Economics

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ABN AMRO Bank
Gustav Mahlerlaan 10 (visiting address)
P.O. Box 283
1000 EA Amsterdam
The Netherlands

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