

# Investment Strategy Bulletin

## Structural and cyclical forces to push EURCHF higher

### Investment Solutions

27 May 2021

- EURCHF has experienced a modest appreciation since market sentiment bottomed last spring
- A confluence of both structural and cyclical factors are likely to represent tailwinds that should put upward pressure on the currency pair on a more sustained basis
- We think that EURCHF will edge closer to 1.12 by the end of the year, with risks skewed to the upside. 2022 could see further gains, absent any negative euro-specific developments

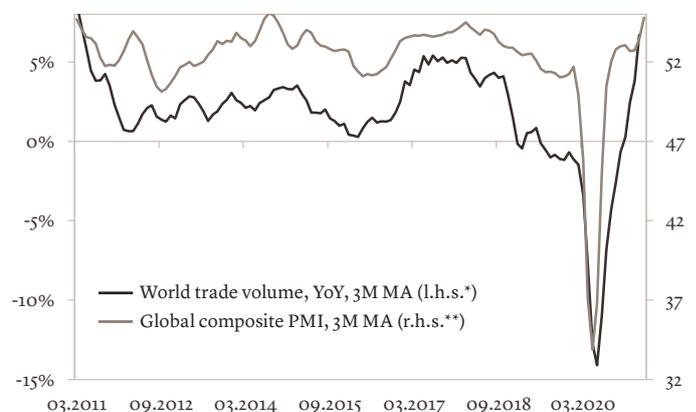
The euro/Swiss franc exchange rate (EURCHF) has been in a modest appreciating trend for the past year. Following a five-year low at 1.05 in May 2020, it has managed to scoop up gains and now trades around the 1.10 level. We see the rise extending further, with EURCHF ending closer to 1.12 this year; risks are skewed to the upside. Our view is based on both structural and cyclical factors.

**On a structural level**, the pandemic shock triggered a historic breakthrough in EU fiscal cooperation. The [NextGenerationEU plan](#) agreed in July 2020 empowered the European Commission to raise up to EUR 750 bn in capital markets to address the economic hardship inflicted by the Covid-19 crisis. Aside from its size, which corresponds to no less than 5.6% of EU GDP, the true pivotal point is the nature of the financing: the plan will be funded via common debt issuance across member states. **Effectively, the “debt-mutualisation taboo” has been broken**, with positive and long-lasting implications for the EU and the euro area. This furthermore will suppress the redenomination (break-up) risk that has haunted the eurozone and the common currency since 2009. The pricing out of this risk premium should underpin the euro while reducing the need to “hoard” safe-haven currencies such as the Swiss franc.

**On a cyclical level**, the global economy is currently in the midst of a very robust recovery following the hit from the pandemic and national-level lockdowns. The global composite

PMI as well as the growth of world trade volume are at levels unseen in a decade (see chart 1). Euro area countries have lagged so far in this rebound relative to the UK and US, due to vaccination bottlenecks. However, the beginning of Q2 21 has seen a significant pick-up in the EU vaccination rollout. Consequently, virus-related restrictions will gradually ease and set the stage for a strong regional economic performance in H2 21.

#### 1. The global economy is experiencing an incredibly sharp recovery



\* left hand scale, \*\* right hand scale  
Sources: Bloomberg, Lombard Odier

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In essence, we are entering a phase during which eurozone growth and sentiment will start showing the benefits of (a) the NextGenerationEU funds, which are about to be disbursed and (b) the sizeable pent-up demand due to the lifting of restrictions. Alongside stronger growth, Bund yields will rise further, extending support to EURCHF (see chart 2). Based on a simple regression analysis, if Bund yields rise to 0% from -0.20% currently, EURCHF should be trading at 1.12. If they revert closer to the 2018 average of around 0.40% (not our base case and a very optimistic scenario), then EURCHF would converge towards 1.15.

Moreover, confidence in the euro area will improve, resulting in an acceleration of Swiss residents' portfolio outflows. Historically, trends in the latter have been closely correlated with EURCHF (see chart 3). Intuitively, when Swiss residents buy foreign assets (such as euro), they convert Swiss francs to foreign (EUR) currencies. Although FX hedging may partially neutralise the impact on EURCHF, evidence presented by Deutsche Bank and Credit Suisse<sup>1</sup> suggests that the acceleration in outflows is also coinciding this time with lower FX hedge ratios. This combination should be de facto positive for EURCHF.

Alas, **there are always risks**. Our constructive EURCHF view will be challenged in case of renewed vaccination bottlenecks that delay the lifting of restrictions and the economic recovery.

This would also force the European Central Bank to remain accommodative for longer and potentially put a stop to the recent ascent of Bund yields. That said, with countries like Germany and Spain having now inoculated 40% of their populations, we judge this to be a low-likelihood event.

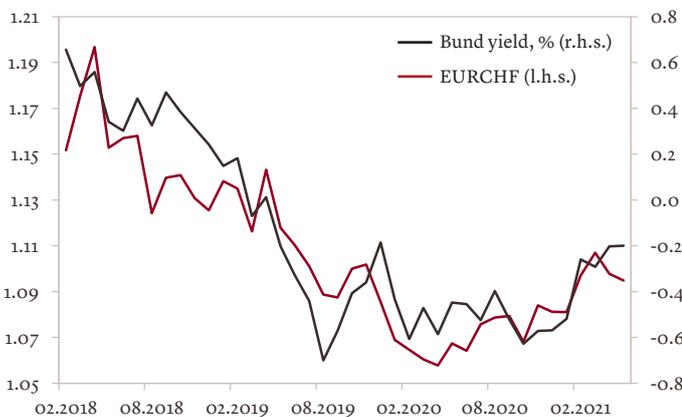
Another risk stems from the possibility of non-effective absorption of the stimulus plan by member states. This would fail to revitalise the regional economies to the level expected, hurt their credibility, and jeopardise further progress on common debt issuance. We feel that the notable decline in European political populism as well as the presence of leading pro-euro personalities in the European political arena (e.g. Emmanuel Macron in France, Mario Draghi in Italy, as well as a deeply growth-devoted government in Greece) suggest that the risk here, too, is low. Moreover, it may be further reduced in case of a Green win in the September 2021 German elections: this could lead to looser fiscal policies and, importantly, more progress on structural reforms.

Finally, a “black swan” event can never truly be ruled out; but realistically, investments and forecasts cannot rely upon unknown catastrophes to form their central scenario.

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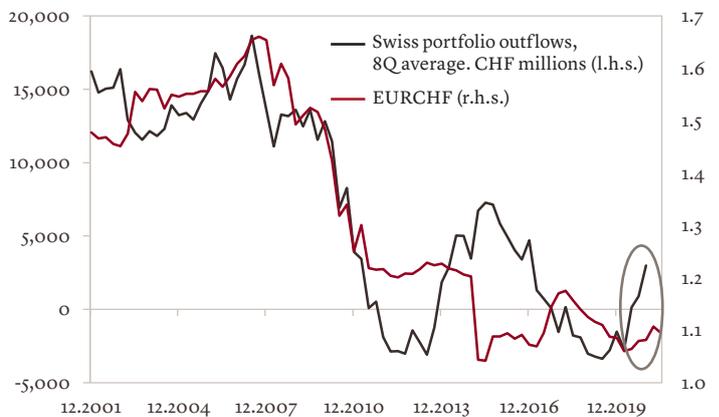
<sup>1</sup> See DB FX Blueprint May 2021

## 2. EURCHF and bund yields closely correlated



Sources: Bloomberg, Lombard Odier

## 3. Swiss portfolio outflows are accelerating



Sources: Bloomberg, Lombard Odier

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