# FX: Embracing the strong Euro

The euro's rise is neither overdone, nor unjustified

Source: istock

## USD: Still treading water

The US dollar continues to trade on the soft side as the generally benign risk environment benefits activity currencies. Unless a currency is weighed down by specific idiosyncratic negatives (ie: the Turkish Lira and geopolitics), it is difficult for it not to appreciate against the USD, particularly when the Trump uncertainty factor is not a positive for the dollar. With the focus shifting to the ECB's policy normalisation (see below), we continue to view the Central and Eastern Europe currencies as the top Emerging Market FX pick, as this is the only EM region that neatly and directly benefits from higher EUR/USD. As per 2018 FX Outlook, we expect USD/Czech Koruna to fall materially.

## EUR: Rise neither overdone nor unjustified

Even after breaking yet another multi-year high and being close to the 1.2300 level, we see EUR/USD as still undervalued - by around 1-2% based on our short-term fair value model (see EUR/USD close to 1.23 is still undervalued for details). This points to a benign outlook for the cross, with fairly limited downside risk and more strength to come this year as the ECB moves closer to the end of QE and the second step in its policy normalisation process- deposit rate hikes (see Embrace the strong EUR for the full EUR outlook). Remarks from the ECB's Ardo Hansson yesterday on the possibility of an abrupt end to QE (suggesting a rising probability of no QE extension beyond September) support the constructive EUR outlook. Despite news about possible hurdles in the

German coalition talks, the EUR/USD should stay above the 1.2200 level today, as the ECB factor is in our view a more important driver for the common currency.

## GBP: Below consensus core UK CPI to weigh modestly on GBP today

We look for both headline and core December UK CPI to decline to 3.0%YoY and 2.5% respectively. Particularly for the core reading, our economists look for a below-consensus reading due in part to the decline in airfares (and expect core CPI to reach 2%YoY this summer – see Where next for UK inflation?). A downside surprise to the core CPI may modestly weigh on sterling today given that the currency has been supported in part by the expectation of tighter BoE policy. EUR/GBP could re-test the 0.8900 level.

## PLN: Muted core CPI no reason for PLN weakness

Our economists expect Polish core CPI to stay at 0.9% YoY. Despite the rising wage pressures (6.5% YoY), this is not being translated into higher core prices, due in part to productivity catching up with wages. Hence, we don't expect the National Bank of Poland to hike this year (MPC Review). As for EUR/PLN, the dovish MPC is not new news following the January MPC meeting and so we don't expect today's core CPI to affect EUR/Polish Zloty, with the cross broadly staying in the 4.17-4.18 area.