

Investment Research

FX commentary  
BoE, ECB and Riksbank rate cuts

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## Global policy rates are coming down

At today's monetary policy meetings, the Bank of England (BoE) and the European Central Bank (ECB) have announced significant rate cuts: BoE by 100bp and ECB by 75bp. Also, the Swedish central bank, Riksbanken, took markets by surprise by cutting rates by an unprecedented 175bp.

Earlier this week, the Reserve Bank of Australia (RBA) lowered rates by 100bp and the Reserve Bank of New Zealand followed yesterday with a 150bp rate cut.

### **Below are our initial thoughts:**

- Today's interest rate announcements have not made us change our general view on the G10 currencies. We expect EUR, SEK, and GBP to see sustained pressure in the short term – not least against USD, CHF, and JPY.
- Today's central bank action does, however, show a willingness from the world's central banks to address a very difficult economic outlook. This should, in combination with the numerous rescue packages, help lead a recovery in risk sentiment and eventually a recovery in SEK and GBP against EUR.
- Those currencies that are backed by a central bank that has been “behind the curve” in terms of easing monetary policy enough (e.g. SEK, EUR, NZD, and to some extent GBP) have generally weakened against currencies backed by more pre-emptive central banks (e.g. USD and AUD). We expect this pattern to continue (ceteris paribus) thereby weighing on EUR.

# Currency implications

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**EUR/USD:** The established (approximate) 1.25-1.30 range in EUR/USD has proven very resilient, as not even a confirmed turn in the pace of ECB monetary policy easing could send EUR/USD meaningfully lower. We do, however, continue to see USD potential relative to EUR, as both the Euroland economic and monetary policy cycle is lagging the US.

However, the link between relative interest rates and FX movements has faded during the past few months, which could reduce the downside potential on EUR/USD compared to our prior expectations of the effect from relative monetary policy.

**EUR/GBP:** EUR/GBP has traded higher during the last few days and we expect the market environment to remain difficult for GBP in the coming months. Further, monetary policy easing and historically weak UK activity data is likely to keep EUR/GBP elevated. However, we still see long-term potential for the now undervalued GBP - especially against EUR.

**EUR/SEK:** Although the market's reaction was to send EUR/SEK above 10.50, the Riksbank has shown its commitment to providing support to recession-hit Sweden sooner rather than later. This could prove positive for SEK in the medium term. On a shorter horizon, however, SEK remains driven by risk sentiment and we expect the krona to remain under pressure. Although this week's rate cuts may mitigate financial conditions somewhat, the risk of a further squeeze in the near term remains.

# Central bank outlook

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- ECB: Has cut by 75bp to 2.50% today. We expect the ECB to cut rates by 50bp in January and by 25bp in both February and March. In total this should bring the leading rate down to 1.5% before the end of Q1.
- BoE: Has cut by 100bp to 2.00% today. We expect a further cut of at least 50bp in January.
- Riksbanken: Has cut by 175bp to 2.00% today. Says that the repo rate will remain at this level until Q4 2009, and rise from there in early 2010. However, it is still the case that our macro forecast compares negatively to Riksbank's. Hence, we expect Riksbank to cut by another 100bp to 1% by summer 2009.

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