



FX Forecasts and Valuations

Don't throw in the towel

Now is not the time to 'throw in the towel' on the strong US dollar trade that in broad USD trade weighted terms likely has at least another 10% to go. The scenario analysis below outlines how the risk environment, notably events in China, will dictate the extent to which dollar strength is concentrated in EM and commodity FX, or rotates back to the major G10 currencies as well.

It's still far too early to throw in the 'strong USD towel'. Instead, 'the rotation' story highlighted in the January 2015 FX forecasts and valuation publication still applies. In the big picture, dollar strength continues to migrate. It started with the yen, moved to 'the Fragile 5', the EUR, commodity currencies, and the spotlight is now shining brightly on non-Japan Asia FX, with serious ramifications for most EM and commodity currencies. What has been notably absent in the latest phase is USD vigor against other G4 currencies, which deserves special attention to ascertain the conditions when this could reassert itself, but this should not distract from the dollar's strength seen elsewhere.

Table 1: States of the world and the EUR 'S-curve'

State 4: risk extremely negative	State 1: risk unchanged/positive
<ul style="list-style-type: none"> Fed reacts by easing (negative rates) ECB & BoJ add to QE USD stronger then sharply weaker EMFX "V" (slump then partial sharp recovery) FX volatility extremely elevated EUR/USD : risk off → parity Fed responds → 1.20+ 	<ul style="list-style-type: none"> Fed tightens, ECB & BoJ on hold Broad USD gains EM& Commodity FX do not further underperform EUR by much EUR/USD tests 1.05 (EUR/USD down ~10 big figures for every 100bps the 2Y spread moves in favor of USD)
State 3: risk consistently negative	State 2: risk noisy, modestly negative
<ul style="list-style-type: none"> Fed steady ECB & BOJ add to QE USD stronger vs. G3 EUR/USD to 1.05 then test parity 	<ul style="list-style-type: none"> Fed steady, ECB steady USD slightly weaker vs. G3 USD/Majors volatility is contained G4 FX outperforms EM and Commodity FX EUR/USD 1.08-1.15 range bound

EUR/USD S-Curve

Source: Deutsche Bank

Deutsche Bank Securities Inc.

DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MCI (P) 124/04/2015.