

W U T I S



Global Markets Division

Behavioral Equilibrium Exchange Rate (BEER)

Currency Trade

Investment Horizon: 1 Year

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Team Overview

Global Markets



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- Trade Setup



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- Currency Selection
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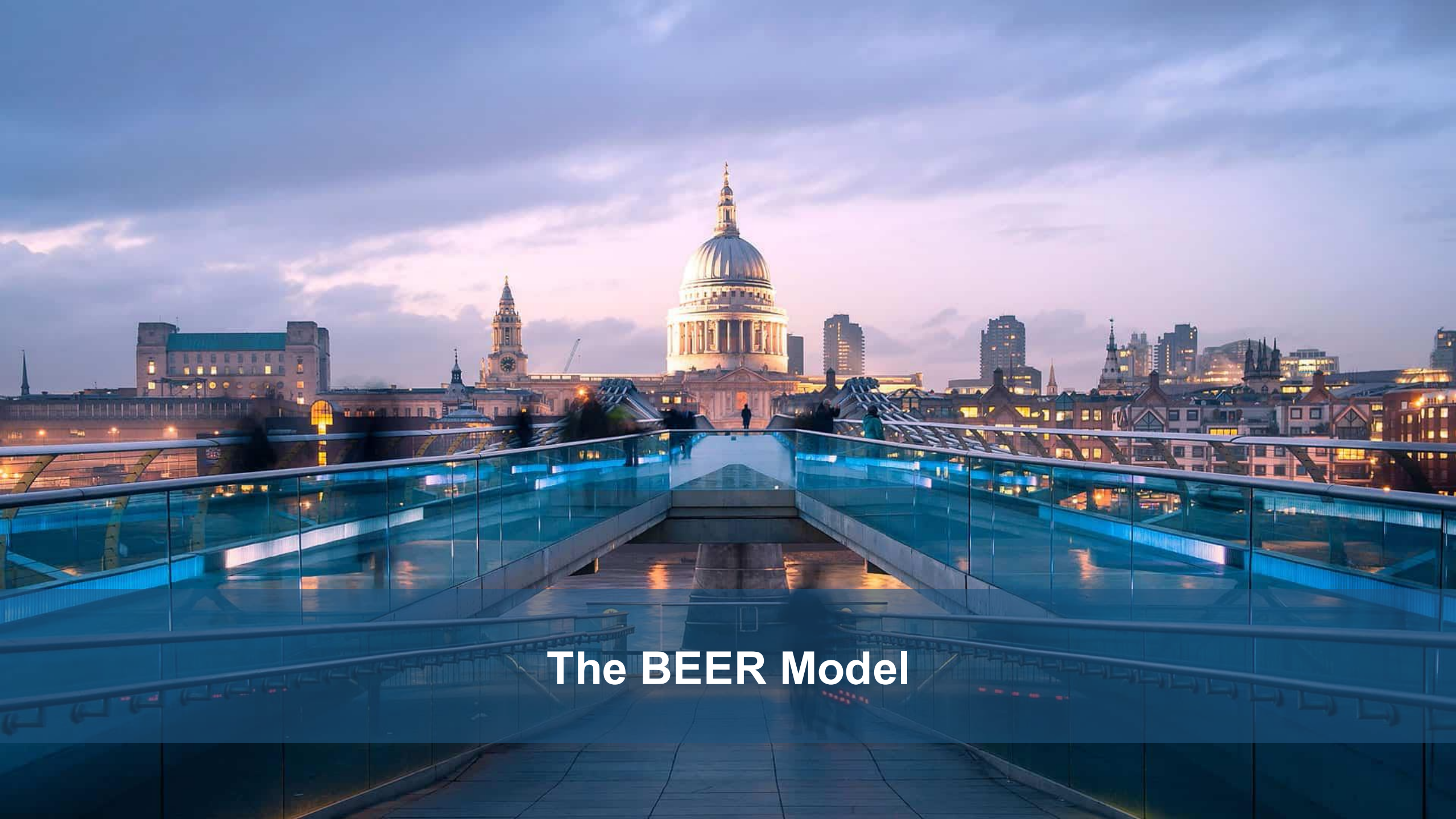
Fellow Analyst

- BEER Analysis
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BSc. WiSo (WU)
4th Sem.

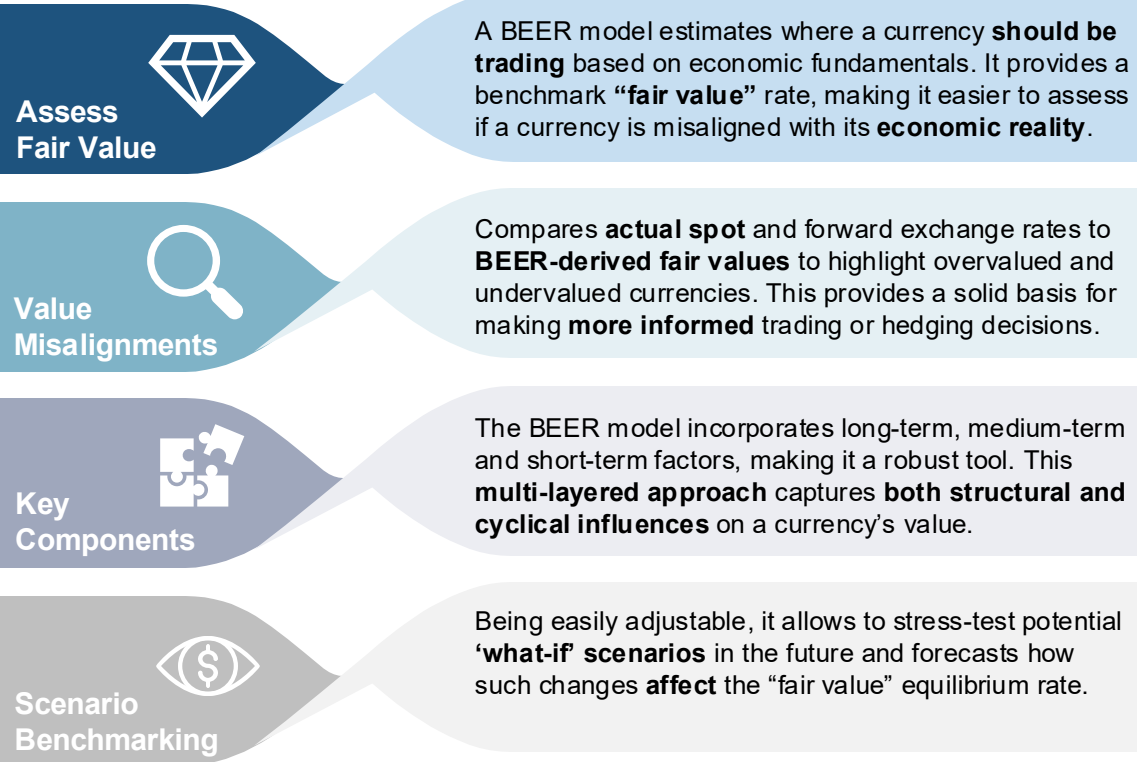
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The BEER Model

Understanding the Concept

Purpose and Benefits of the BEER Model

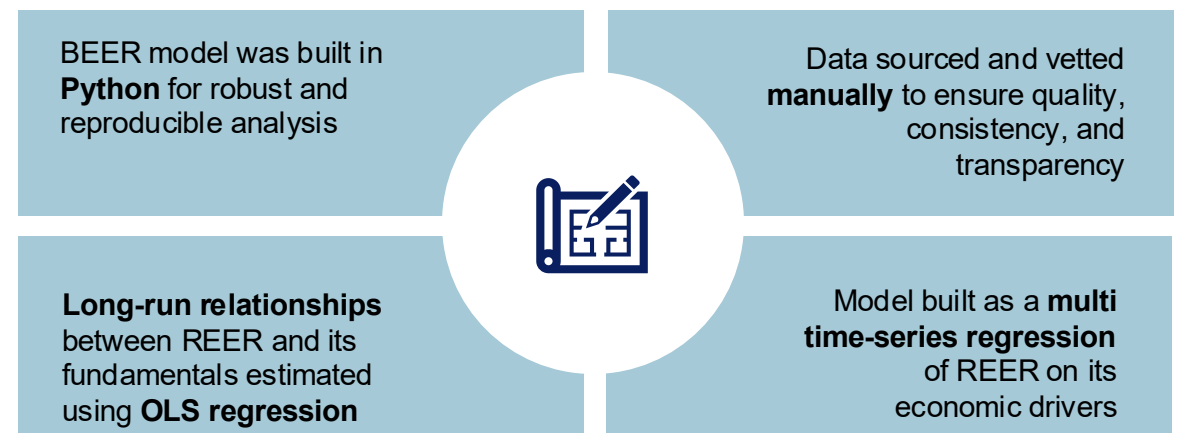


$$\log(REER) = \alpha + \beta_1 \log(GDP_{pc}) + \beta_2 \log(CPI) + \beta_3 \log(Trade) + \epsilon$$

Model Overview

- 1 Our model **analyzes 14 currencies** consisting of **G10 and 4 EM picks**
- 2 Utilizes data spanning from **Q1 2000 to Q1 2025**
- 3 Operates on a **quarterly data** frequency for robust trend capture
- 4 Incorporates **REER, CPI, GDP per Capita, and Trade** as core inputs for the model

Technical Approach



Currency Selection

Mapping Out the Selection Process

Strategic Selection

Define Selection Criteria

Prioritize **G10** currencies for relevance and liquidity and incorporate emerging markets to capture regional **diversity** and **structural misalignment** potential

Screen with Strategic Filters

Screen EM currencies based on trade exposure, capital flow importance, global financial presence, and **monetary regime diversity**

Build Candidate Set

Identify currencies that meet the strategic filters and hold **potential** for meaningful **macroeconomic insights**

Model Suitability Test

Data Availability

Ensure **consistent macro data** for key BEER inputs like productivity, interest rates, and external balances

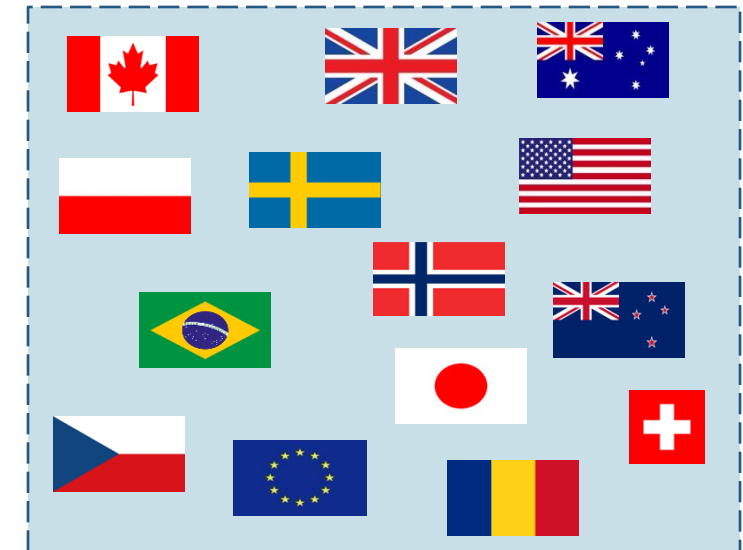
Suitability Assessment

Testing behavior of candidate currencies within the BEER framework, **ensuring economic interpretability**

Final Selection

Select currencies that **align** with **technical model** requirements and **passed suitability tests**, supporting reliable output

Results of the Screening Process



The selected currencies were chosen for their **strategic relevance** and **model suitability**, fulfilling the predefined criteria for model estimation and providing great foundation for a meaningful misalignment analysis.

How Each Variable Influences the “Fair Value” Exchange Rate

Real Effective Exchange Rate (REER)



Inflation adjusted trade weighted exchange rate index



Dependent variable explained by **fundamentals**



Used as **benchmark** to compare against **BEER**

$$REER = NEER \times \frac{\text{Foreign CPI}}{\text{Domestic CPI}}$$

GDP per Capita (PPP)



Income per person adjusted for **purchasing power**



Proxy for **productivity** and **structural strength**



Higher **GDP per capita** increases **BEER**

$$GDP \text{ per Capita} = \frac{GDP \text{ in USD}}{\text{Population}}$$

Consumer Price Index (CPI)



Standard measure of **consumer price inflation**



Reflects **relative competitiveness**



Higher **CPI** lowers **BEER**

$$CPI = \text{Price Index of Goods (relative to base year 2010)}$$

Trade Openness (as % of GDP)



Sum of **exports** and **imports** as share of **GDP**

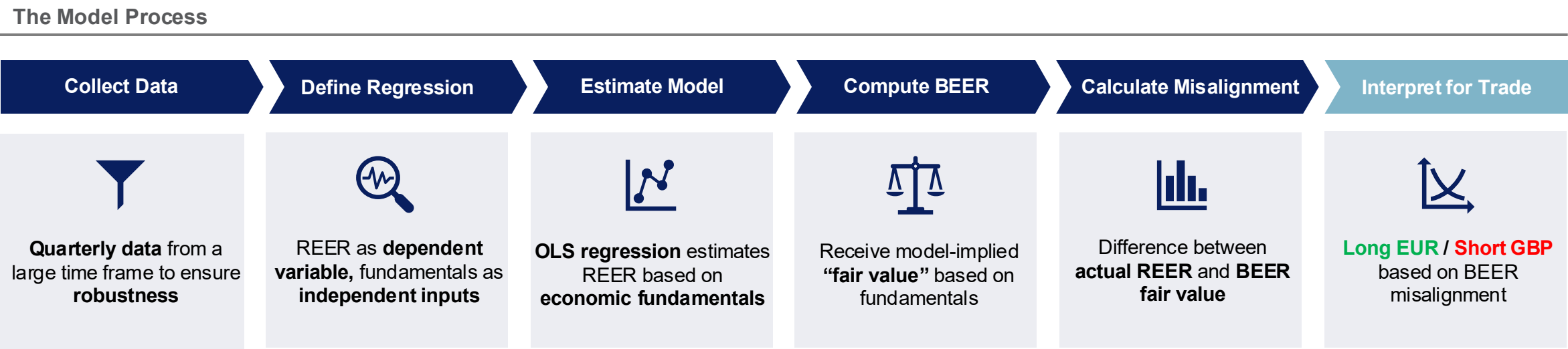


Indicates level of **trade integration**

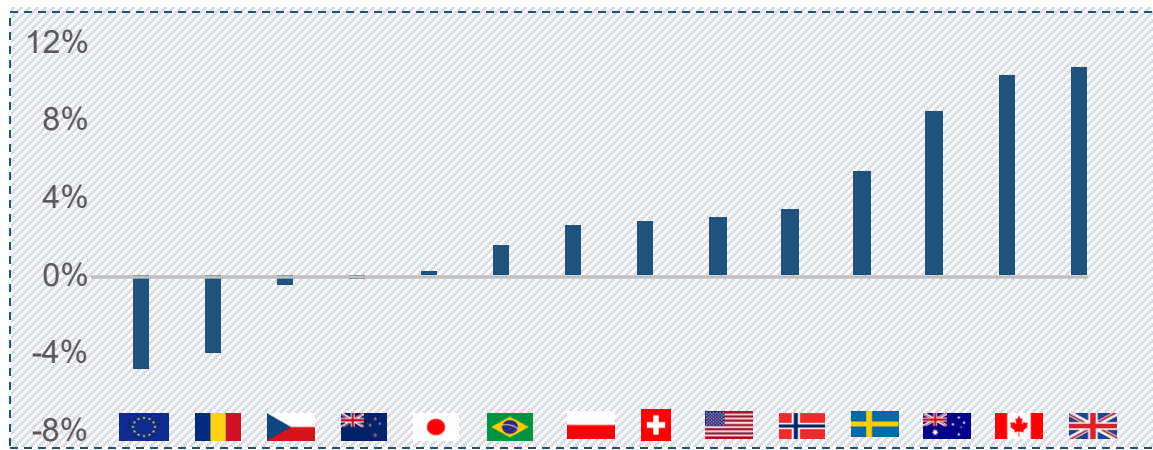


Higher **trade openness** increases **BEER**

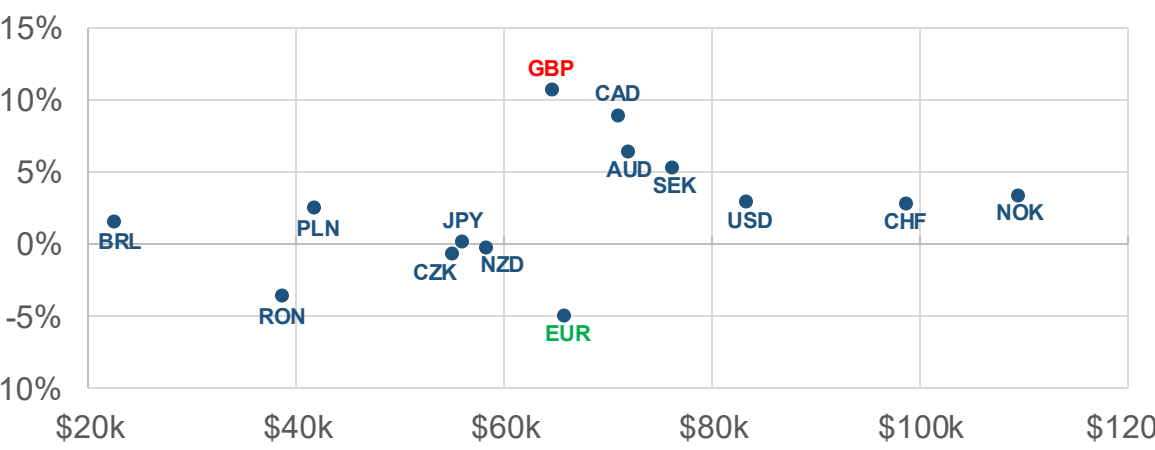
$$\text{Trade Openness} = \frac{\text{Exports} + \text{Imports}}{GDP} \times 100$$



Currency Misalignment Summary



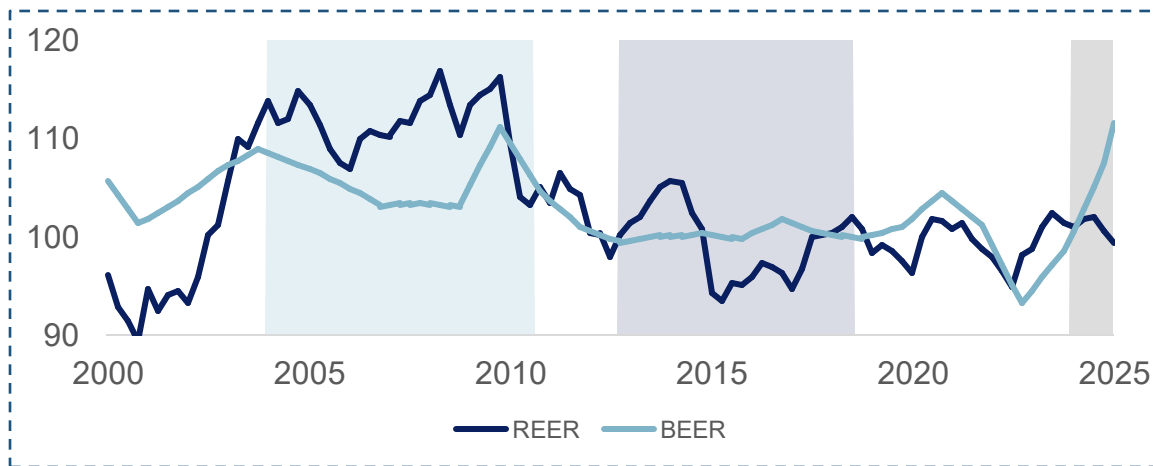
“Fair Value” Misalignment in Relation to GDP per Capita



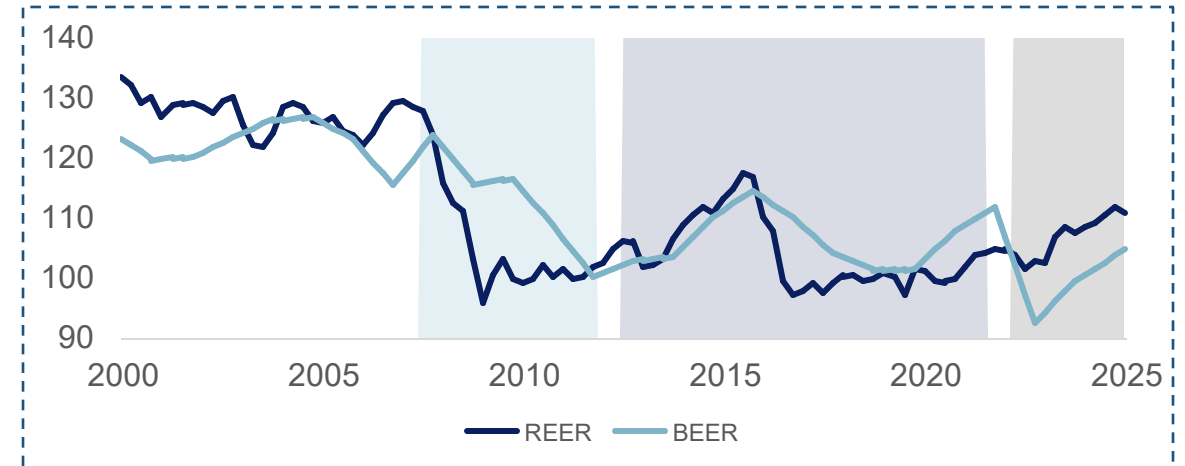
Analyzing BEER Model Outcomes

Historical Over- and Undervaluation of the EUR and GBP

EUR: REER vs BEER (relative value)



GBP: REER vs BEER (relative value)



2004-2010



EUR was continuously **overvalued** according to the BEER model due to **favorable interest** rates and confidence in EUR

2012-2018



Low inflation led to a short period of **overvaluation** which then switched to – **undervaluation** due to the QE from the ECB

2024-now



EUR significantly **undervalued** by the largest margin observed in the sample period due to the **inflation gap**

2008-2012



GBP was significantly **undervalued** due to high exposure to the financial crisis and the BoE's aggressive **monetary easing**

2012-2021



Relatively close convergence indicating **macroeconomic alignment** and fair valuation

2022-now



First time consistently **overvalued** for a longer period since the early 2000s mostly due to the **delayed rate cuts**



Eurozone Macroeconomic Analysis

Disinflation with Fragile Growth Supports EUR Repricing

Overview



Moderate growth
amid uncertainty,
stable government
deficits due to **EU** rules



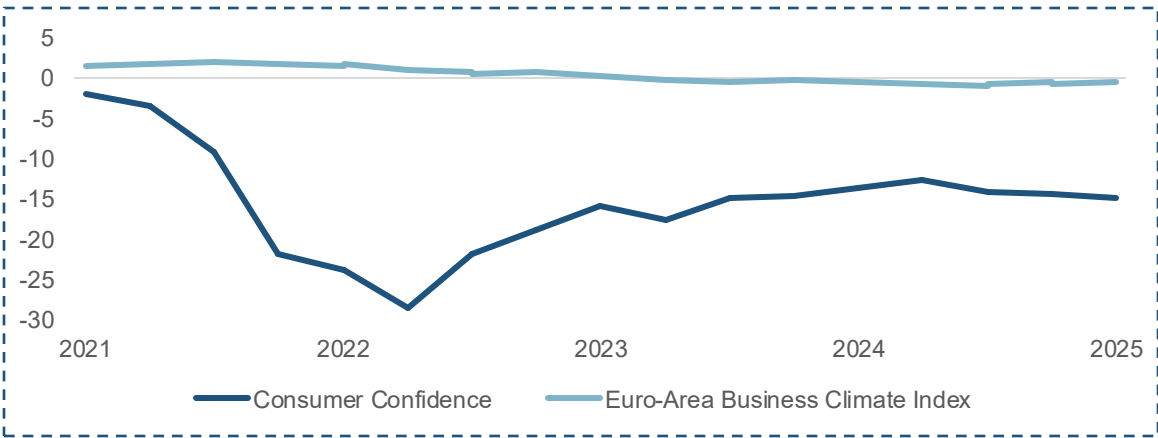
Strong labor markets
and inflation near
long-term 2% target



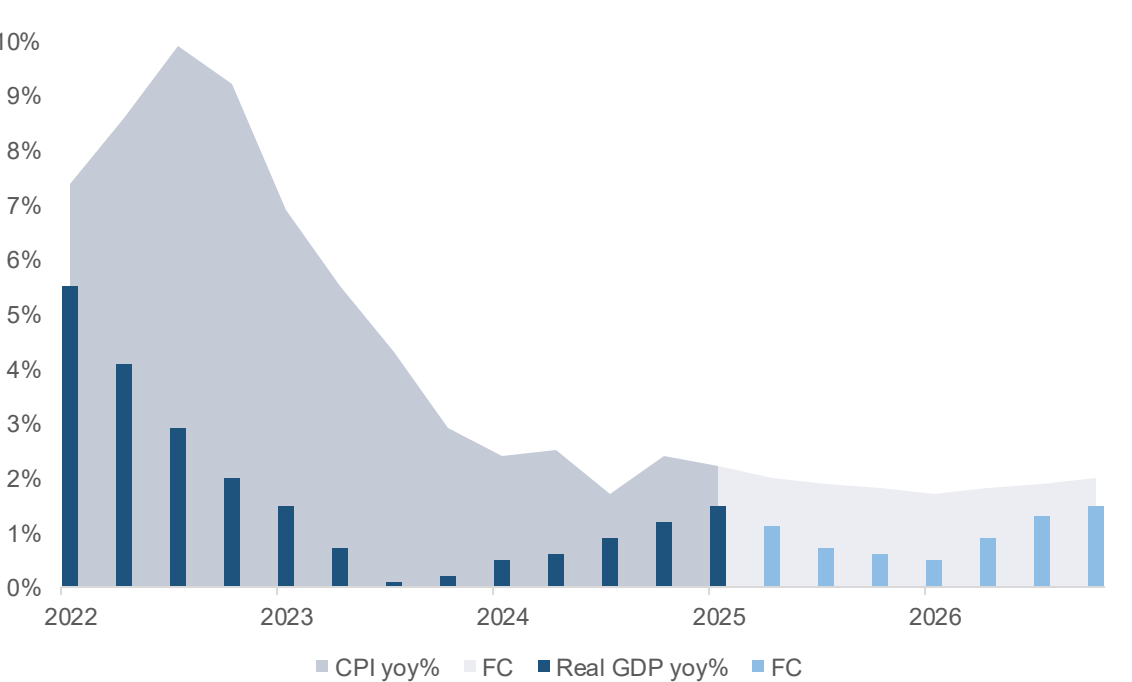
Consistent **current
account surplus** and
growing capital inflows
as EUR is increasingly
seen as a **safe haven**

Moderate growth and shifting monetary policy strengthen EUR

Market Confidence



Trends in CPI and GDP Growth



The Eurozone **economy grew by 0.6%** in the first quarter of 2025, **doubling the earlier estimate** of 0.3%



Eurozone headline **inflation fell to 1.9% in May 2025**, marking the first drop below the ECB's 2.0% target since September 2024

Monetary Policy



“I think we are getting to the end of the monetary policy cycle, that was responding to compounded shocks”
– Christine Lagarde (ECB President), 5 June 2025



No pre-commitment reflects the ECB's response to uncertainty



Markets are currently **pricing in one more 25 bps cut** by the ECB this year

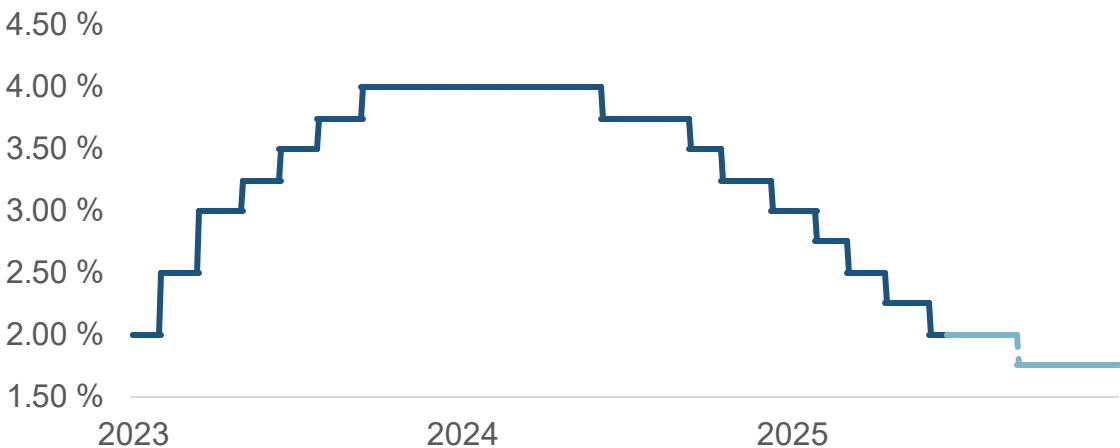
Fiscal Policy

Growth supportive policies

Diverging fiscal stances across member states

Stabilizing political environment

Eurozone Interest Rate Forecast



Assessing Risks

Tariff Uncertainty

EU-US trade talks remain uncertain amid internal divisions and sector-specific tariff threats

Export Headwinds

A stronger euro could weigh on exports and raise concerns over external competitiveness

Manufacturing Weakness

Weak industrial output persists in several member states, clouding near-term growth outlook

Policy Fragmentation

Diverging fiscal strategies among member states may challenge unified policy coordination

An aerial photograph of the London skyline at sunset. The sun is a bright, glowing orb in the upper center, casting a warm orange and yellow light across the sky and the city. The River Thames flows through the center of the image, with several bridges visible. The skyline is dominated by modern skyscrapers, including the Shard on the left, the Gherkin in the center, and the Walkie-Talkie on the right. The city extends far into the distance, with a dense grid of buildings. A semi-transparent blue banner is overlaid at the bottom, containing the text "UK Macroeconomic Analysis".

UK Macroeconomic Analysis

Macroeconomic Analysis UK I.

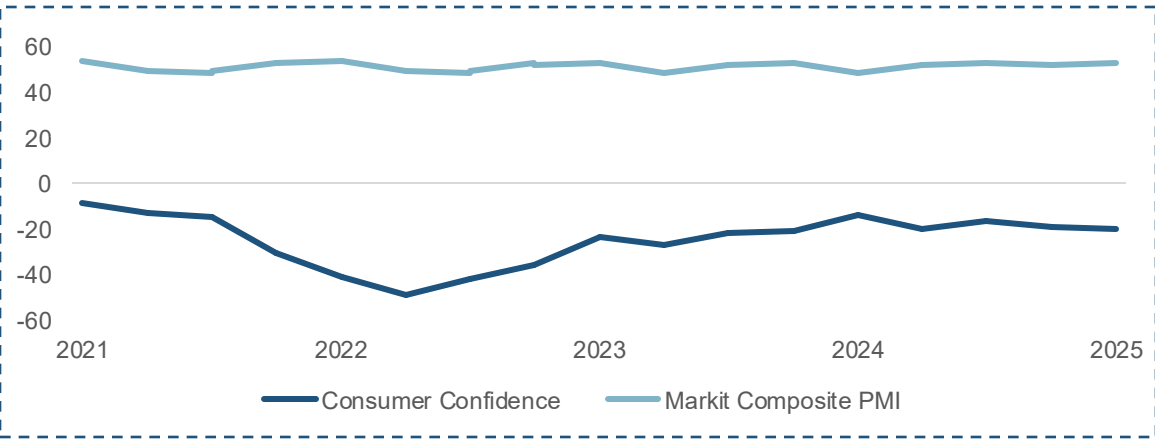
Subdued Growth and Lingering Inflation Risks

Overview

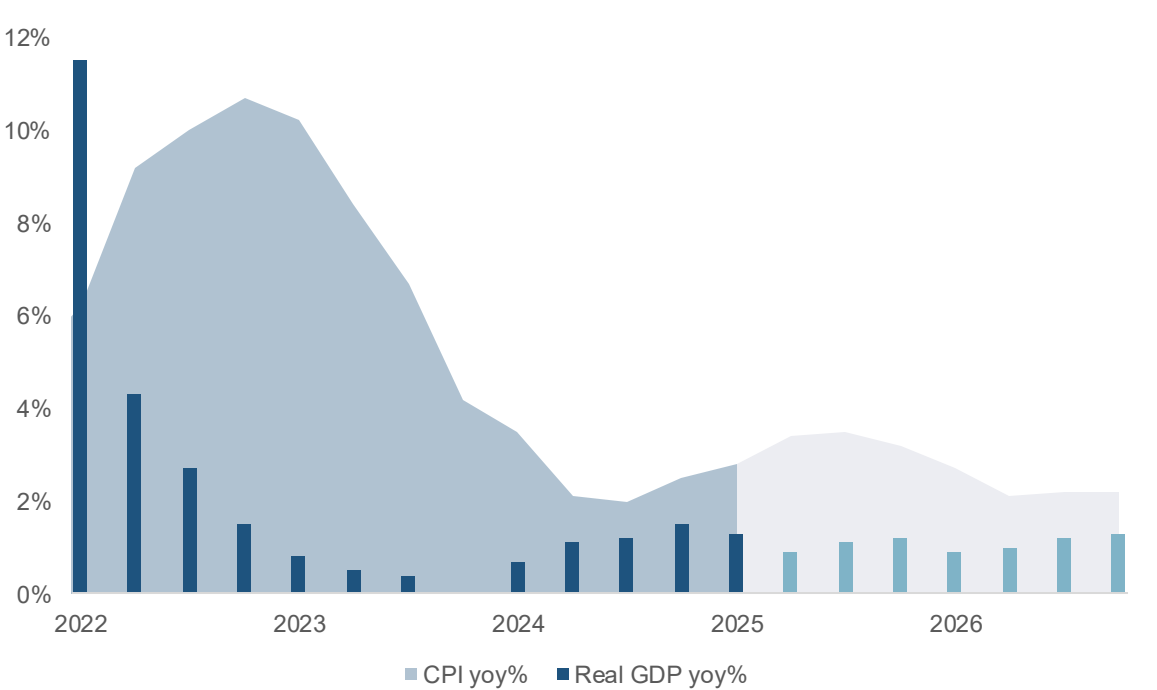


Weak economic outlook making way for rate cuts and currency depreciation

Market Confidence



Trends in CPI and GDP Growth



Inflation declining close to ~2% by end 2025 , while **GDP growth stagnates** below 1% - reflecting **limited** domestic demand **recovery**

Market confidence indicators improved slightly post 2022 lows, but remain historically weak - showing **consumer caution** and **low business momentum**

Monetary Caution Meets Fiscal Pressure

Monetary Policy



“Interest rates remain on a gradual downward path, although we left them on hold today”
– Andrew Bailey (BoE Governor), 19 June 2025



BoE held rates at **4.25%** in a **6–3 vote**, with dissenters favoring a cut amid weak growth and a loosening labor market



Markets are currently **pricing in two further quarter-point** interest rate cuts by the BoE before the end of the year

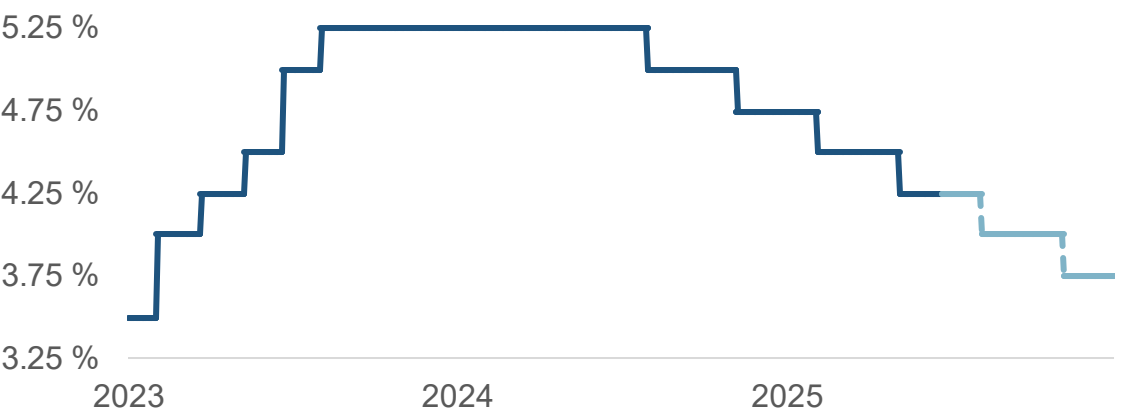
Fiscal Policy

Government is not expected to meet fiscal deficit

Tax hikes are expected in the autumn budget

Tariff agreement reached with the USA

UK Interest Rate Forecast



Assessing Risks

Oil Price Sensitivity

Oil prices remain under close watch amid geopolitical tensions in the Middle East

Wage Pressure

Persistent wage pressures may keep services inflation elevated, forcing the BoE to maintain a restrictive stance

CPI Data

A rebound in GDP or strong consumer data could improve sentiment toward the pound

Labour Market

A stabilizing labour market could shift policy outlook, reducing urgency to cut interest rates



The Currency Trade

Currency Trade Setup

W U T I S

Capitalizing on Currency Mispricing

GBP Positioning

British Pound trades **10.74% above fair value**, near peak of historical misalignment range

Policy divergence intensifies, with **two further expected BoE rate cuts** in 2025

Weak fiscal outlook and rising tax burden **undermine structural confidence**

Short GBP:

Position via FX forwards or futures

Stronger mispricing and earlier BoE cuts justify a larger high-conviction short allocation

EUR Positioning

Euro trades **4.91% below fair value**, with consistent undervaluation over recent months

ECB priced for **one more 25bps rate cut** in 2025, limiting scope for policy-driven downside

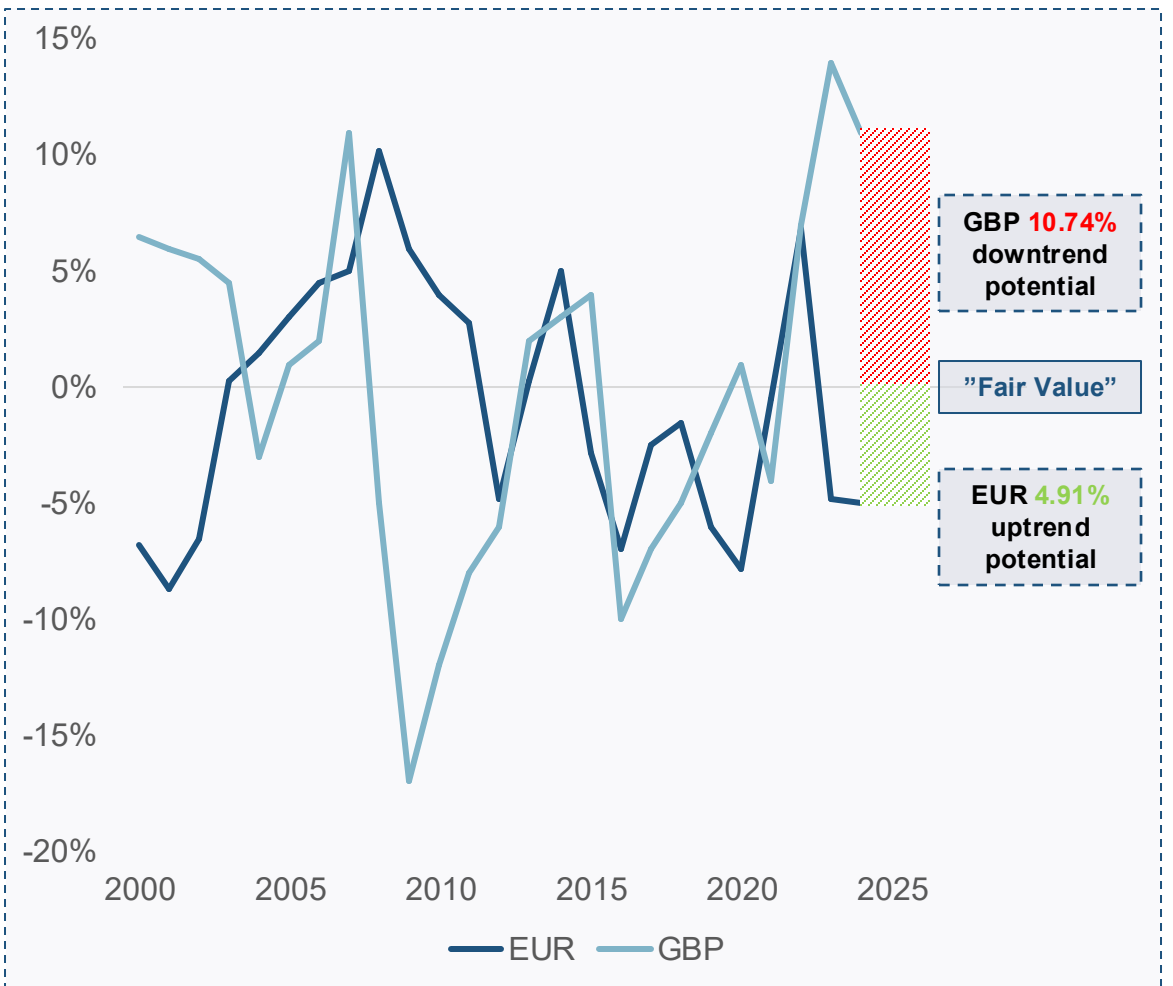
Improving business sentiment and stable external balance **support gradual revaluation**

Long EUR:

Position via FX forwards or futures

Limited ECB activity and steady undervaluation support a controlled long position

EUR GBP Misalignment chart



A low-angle, upward-looking photograph of several modern skyscrapers. The buildings are constructed with dark, grid-like facades and glass windows. The perspective creates a sense of height and scale, with the buildings converging towards the top of the frame. The sky is a clear, pale blue. The overall color palette is dominated by blues and greys, giving it a professional and architectural feel.

Appendix

Sources

Source Name	Link	Date of Retrieval	Used for
Bloomberg Finance L.P.	-	BEER Model Data, Macroeconomics	Continuous use
Trading Economics	Link	5/18/2025	Model Methodology
IMF	Link	05/18/2025	Model Methodology
University of Glasgow and Peterson Institute of International Economics	Link	05/18/2025	Model Methodology
Goldman Sachs	FX in Focus: Do BEER Models Work? (2019)	05/18/2025	Model Methodology
Bank of America	FX Value: We prefer BEER (2018)	05/18/2025	Model Methodology
Bank of America	A primer on G10 equilibrium exchange rates (2019)	05/18/2025	Model Methodology
Bank for International Settlements	Link	06/10/2025	REER
World Bank	Link	06/10/2025	CPI, GDP per Capita, Trade
BBC	Link	06/20/2025	UK Monetary and Fiscal Policy
ECB	Link	06/21/2025	Eurozone Monetary Policy
Reuters	Link	06/23/2025	UK Economic Information

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