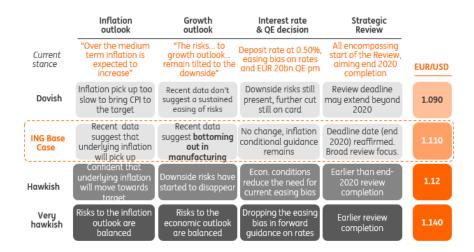


Article | 21 January 2020

ECB and EUR crib sheet

The euro should largely look through this week's European Central Bank meeting, with EUR/USD risks remaining skewed to the downside. The attractive funding characteristics of the euro should be kept in place by the ECB for a while yet



ECB's wait-and-see approach doesn't point to much upside for the euro

The January meeting of the European Central Bank should have a little impact on the euro. No new economic projections will be published and the board is unlikely to change its risk assessment (see ECB Preview for details). An official announcement that the bank is launching its strategic review has been well-flagged and is not likely to affect the euro materially either.

With euro rates deeply negative and little prospect of a turnaround in the near-term (for this to happen, we would need to see a more pronounced rebound in eurozone data and the ECB dropping its easing bias on rates – which is unlikely at this point, and features as a risk scenario in our ECB crib sheet), the outlook for the euro remains unattractive and the currency is likely to continue to be used as the funding vehicle of choice for carry trades.

Euro shows no sign of recovery

We continue to see EUR/USD risks as skewed to the downside in coming weeks (towards / modestly below the 1.10 level) should the use of the euro as a funding currency become even more pronounced or global economic data disappoint. Talk of a Republican tax cut 2.0 may also

Article | 21 January 2020

add to a downward EUR/USD trend.

Even if the global economic outlook improves and this positively affects data from the euro area (the eurozone is a big open economy), this wouldn't necessarily be overly positive for EUR/USD because while it would signal a less dovish ECB (perhaps encouraging the bank to reconsider its easing bias) it would also likely be accompanied by a hawkish re-pricing of the Federal Reserve's outlook, where close to one 25 basis point cut is currently priced in for this year.

With EUR/USD showing no urgent sign of mis-valuation (as per 2020 FX Outlook, our Behavioral Equilibrium Exchange Rate model suggests the cross is currently fairly valued after the non-negligible decline in EUR/USD fair value since 2017), we see a limited upside potential for the cross at this point.

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