

EUR: Another punch from the ECB to the euro

The ECB is slowly but surely taking away factors for a domestically induced EUR rally. With the Fed due to hike in Q3, we expect EUR/USD to fall to 1.10. The dovish ECB is negative for SEK but positive for HUF



The dovish surprise

The ECB delivered a dovish surprise today, EUR/USD broke decisively below the 1.1300 level and the cross is not shy away from our 1-month target of 1.1200. That dovish surprise was caused by the mix of two factors:

- (1) the official announcement and details of TLTROs;
- (2) the shift in the ECB forward guidance announced already in the meeting today, with the ECB signalling it won't increase interest rates until end 2019

Interestingly, the Council also discussed prolonging the guidance to March 2019; see our [ECB: Dovish gamble](#) for more details.

Implications for EUR/USD

Still, with the market expectations already, to a great extent, pencilling in a cautious / dovish ECB stance after yesterday's rumours and the forward guidance being extended by one quarter only (from the end of the summer to the end of 2019), this means the ECB generated downside to EUR should not be pronounced from here. This is due in part to the already very subdued market pricing of the ECB tightening prior to today's meeting, meaning the potential for an excessive dovish re-pricing was rather low to start with.

As a result, we don't look for a pronounced collapse in EUR/USD but rather expect an orderly decline below 1.1200 and target the 1.1000 level once the divergence between the Fed and the ECB kicks in again. Here, our economists expect the Fed to deliver a hike in Q3 which is currently not priced in by the market. EUR/USD is likely to test 1.100 within months.

The extension of the ECB forward guidance today suggests the second step of the ECB policy normalisation (i.e. the rate hikes - after the first step being the end of QE) is a very distant possibility. This means that something similar to the 2017 euro rally is off the table (at the time caused by market expectations of ECB QE tapering). Any meaningful EUR/USD upside is likely to chiefly come (if it comes) from a weaker USD environment. As per above, this is unlikely to occur in the coming months as the Fed should deliver one more hike.

Spillovers: Negative for SEK, positive for HUF

In terms of spillovers, the extension of the ECB forward rate guidance should further increase the bar for the Riksbank to hike later this year (a hike which has been already highly questionable) and underscores our negative view on SEK. We look for EUR/SEK to break above the post-crisis high of 10.7291 in 2Q (see [SEK: Struggling to find the silver lining](#)).

The shift in the ECB's stance is positive for short EUR/HUF positions as the ECB becoming more dovish and the NBH announcing the BUBOR normalisation later this month will further underscore the near term policy divergence and help HUF. Note that despite the ECB dovish bias today, NBH is unlikely to postpone the start of BUBOR normalisation as core CPI is heading higher (as we will see again tomorrow when Feb CPI is released in Hungary).