

## EUR: Draghi's magic still works

Despite high expectations, Draghi managed to transform the event of the quarter into a non-event with limited reaction from markets



Source: iStock

The European Central Bank delivered the QE tapering in line with consensus extending it by EUR 30bn per month until September 2018 - an additional nine months of purchases.

Yet, given the existence of a non-negligible risk of a hawkish form of QE tapering going into the meeting (i.e. EUR 20-25bn over nine-months), the knee-jerk reaction was a lower EUR/USD and lower bund yields.

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Looking ahead, we stick to our existing base case of EUR/USD settling into a multi-month trading range given:

- (a) The non-disturbing and in-line-with-the-market-expectations QE tapering announced today.
- (b) Upcoming Italian election in 1H18 which should limit the scope for higher bund yields and thus a higher EUR.

Once we pass the Italian elections and approach the end of the current tapered form of the QE program, we expect the EUR to rise in line with higher bund yields. Moreover, in 2H18 we look for the second “discrete jump” in EUR/USD higher (to 1.30 by end 2018) prompted mainly by the market repositioning for a normalisation of the deposit rate towards zero.

Although we only look for a deposit rate hike (from current -0.40%) in 2019, in line with the today's reiterated notion of the sequencing (that is for the ECB to end the QE first, and only then hike the depo rate). We expect the market to start pricing this event well ahead of its start – in the same way, the level of EUR currently reflects the upcoming QE tapering, although it has not started yet.

In terms of the implications for broader FX markets, today's neutral and non-disturbing QE tapering announcement should be positive for high yielding currencies. From the European core yield perspective, today's announcement puts to bed the risk of the ECB prompted bond sell-off.

However, at this point, we still need a confirmation of the new Fed's Chair for the market to move meaningfully back into carry trades (given the non-negligible risk of John Taylor being nominated for the Fed Chairman, the likely subsequent pressure on global core yields higher and the negative feedback loop into the EM high yielders).

In the CEE space, today's ECB decision should have limited impact on the next week's Czech National Bank meeting where we look for a hawkish 25bp hike (with a risk of some board members voting for a 50bp hike).

This suggests an ongoing and continued grind in EUR/CZK lower. Importantly, the lower ECB QE for longer and the strong reiteration of the notion of sequencing (meaning that the ECB is only likely to hike deposit rates from 2019 onwards) suggests more easing from the NBH and its well-telegraphed attempt to flatten the curve. While this suggests a limited upside to HUF, the HUF IRS curve should flatten.