

EUR & ECB: No fireworks

The cautious ECB tone supports our view that EUR/USD upside next year will be largely about the weak USD, rather than a strong EUR. This also means that even with higher EUR/USD, CEE FX won't outperform its EM peers as much as it did back in 2017



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No surprise, wait for the weaker USD

As widely expected, the European Central Bank (ECB) delivered no fireworks. Instead, it was a cautious tone and downward revisions to both GDP and CPI forecasts. ECB President Draghi's "continuing confidence with an increasing caution" take on the outlook ahead summarizes it the best. Overall, and as per our [2019 FX Outlook: Peak Dollar](#), the cautious ECB is unlikely to be a big driver of projected EUR gains next year and is unlikely to be the catalyst for a sharp EUR/USD rally – as for example was the case back in 2017 when the mix of improving Eurozone growth outlook and expectations of ECB quantitative easing tapering translated into a meaningful EUR rally. We look for higher EUR/USD in 2H19 (targeting 1.20 by end-2019) but this will be more about the weak USD (as we expect the dollar bull cycle to peak) rather than a strong EUR. The euro simply lacks domestic catalysts for a more meaningful rally. The expected 40 basis points of ECB depo hikes (between end-2019 and early 2020) are unlikely to do the trick.

Implications for EM FX: The drivers behind EUR/USD matter

Our take on the drivers behind the expected EUR/USD upside next year (weak USD, rather than strong EUR) also means that even with higher EUR/USD in 2H19, Central and Eastern Europe (CEE) FX is unlikely to be such a meaningful outperformer in the wider Emerging Markets (EM) FX space as was the case back in 2017 (that year Czech koruna and Polish zloty were the two best performing EM currencies). This is because if higher EUR/USD is caused by a weaker USD (and not a strong EUR) this also benefits other EM FX regions and not exclusively CEE FX (which back in 2017 was the chief beneficiary of the ECB induced EUR rally vs its EM peers). The CEE FX segment should do well in USD terms next year, but unlikely to be a meaningful outperformer in the EM FX space.