

## EUR & ECB: No serious hurdles presented

The ECB presented almost no serious hurdles to renewed euro strength as economic forecasts were more upbeat than expected while comments on the exchange rate were fairly soft. Given the outlook, it is hard for ECB to lean against currency strength and with bearish USD dynamics firmly in place, the medium-term upbeat EUR/USD outlook for 2021 remains intact



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### Hard to justify forcefully leaning against strong EUR

As expected, it was a little too early for the ECB to forcefully talk down the exchange rate.

Given the latest set of ECB staff forecasts, it would be almost impossible to justify a meaningful reaction against the strong euro given the largely unchanged GDP outlook and more than upbeat expected CPI outlook (an upgrade to 2021 CPI forecast and no downgrade to the 2022 CPI forecast vs expected downgrades for both years – see [ECB Review](#)).

While it was reiterated multiple times that the Council is monitoring the exchange rate "carefully" and the currency is important for the CPI outlook, given the latest economic projections, this was almost as strong as it could realistically get and a far cry from Trichet-like comments on "brutal" currency strength.

The break-in EUR/USD above the 1.1900, therefore, looks justified.

## The monetary policy stance is already rather stretched ...

Even if the ECB deemed it necessary to credibly lean against the recent currency strength, apart from the possible verbal interventions (which eventually must be followed by real action for them to be credible), it is important to note that the current accommodative ECB policy stance is already rather stretched.

The deposit rate is in deep negative territory (with its positive effect on the economy being questionable) and the central bank has already been engaging in large scale asset purchases. While we continue to see an extension of PEPP beyond mid-2021 as the next ECB step, this is already expected by the market and therefore its negative impact on the euro is unlikely to be meaningful.

## ... and strong bearish dollar dynamics are in place

With strong bearish dollar dynamics in place, it will be a very tough task for the ECB to tame the EUR/USD upside – which we expect to continue into next year and the pair to reach and potentially breach the 1.25 level in 2021. It will not be easy for the ECB to compete with the Fed, which adopted average inflation targeting and cemented the negative-US-real-rates-for-longer narrative.

Adding the US twin deficits to the mix (which gained more importance this year as the dollar no longer benefits from high-interest rate differential), the bearish USD dynamics look too strong to be offset by the ECB.

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