

EUR & ECB: Ready to offset the possible dovish Fed

Despite the lack of explicit action, the European Central Bank (ECB) got as close as it gets to an interest rate cut. This means that if the Fed starts cutting, the ECB will likely do too. Hence, calling for an imminent and pronounced EUR/USD upside may be premature



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As close as it gets

While President Draghi could not deliver a clear and explicit dovish bias due to the lack of a meaningful change to the eurozone (EZ) growth and inflation ECB staff forecasts (note that the ECB staff projections did not fully capture the recent deterioration in the global trade war outlook due to the cut-off date), the signal was very clear. In our view, the ECB is as close as it gets to an interest rate cut (see [ECB: Dovish vehemence from Vilnius](#)). If the Fed is in a situation whereby it needs to cut interest rates (largely due to the trade war effect) it is likely that the ECB will deliver interest rate cuts as well.

ECB ready to cut rates...

Should the global trade wars intensify by the end of June (ie, the US imposing tariffs on all Chinese

exports) our economists don't rule out an ECB cut already in the July ECB meeting (a modest cut of 10bp) before a tiering system is introduced in September (as the ECB will need more time to come up with details of the system) and an even larger cut being delivered then should it be necessary. This all can happen before President Draghi leaves office (his last meeting is in October).

... at least partly offsetting the Fed

This suggests that any immediate upside to EUR/USD can be fairly limited even if the Fed starts the easing cycle (which still remains a big if) as (a) already plenty of easing is priced in for the Fed for this year (close to three 25bp rate cuts); (b) the ECB may follow and deliver further easing via a modest outright cut first and then more meaningful cuts with the tiering system. This means that one central bank's dovish bias can be (at least partly offset) by the other's. Hence, the lack of a sustained break in EUR/USD above the 1.1300 level today and the turnaround when President Draghi mentioned that some board members discussed cuts and quantitative easing (QE).

Calling for an imminent EUR/USD upside is premature

This suggests that calling for an imminent and pronounced EUR/USD upside break from here may be premature as the ECB is unlikely to stand idle if and when the Fed eases. Moreover, as will be the case for the US growth, the eurozone economy will be also affected by the trade wars given the very open nature of its economy (one of the most open in G10 FX space). And there is still President Trump's decision on the EZ auto-tariffs to be made. As per [World trade heading for the worst year since 2009](#), our trade team believes the auto-tariffs will be imposed in 4Q19, which also limits the EUR/USD upside potential as this would be a clear negative for the eurozone economy.