

EUR & ECB: The funding characteristic of the euro still intact

Today's ECB meeting keeps the EUR funding characteristics intact. No longer meaningfully cheap EUR vs. USD, sluggish growth and little prospects of ECB tightening all mean that the euro will continue to be used as a funding currency of choice in 2020. The upside to EUR/USD is very limited



Source: Shutterstock

ECB policy stance to remain very accommodative ...

The December European central bank meeting didn't deliver any major surprises.

The eurozone growth outlook for 2020 has been modestly revised lower as was the CPI outlook for 2021, and the ECB projections for 2022 (GDP at 1.4% and CPI at 1.6%) do not point to any need to change the current (euro negative) monetary policy set up.

Perhaps the most important aspect was President Christine Lagarde's comments on the 2022 CPI outlook and its implication for the ECB stance. Although inflation is expected to increase to 1.7% by 4Q22, this is seen as a move in the right direction, not yet a satisfactory outcome given the existing ECB inflation goal and the forward guidance.

This further reiterates our view that a change in the policy stance towards less accommodative is currently not on the cards. As for the strategic review, it is expected to be completed at the end of 2020, suggesting a limited impact on the ECB reaction function in months/quarters to come.

Making euro an unattractive currency and the funding currency of choice

The above makes EUR rather an unattractive currency within the G10 FX space.

As we highlighted in our [2020 FX Outlook](#), we remain unexcited about the EUR prospects. The currency is no longer meaningfully cheap vs. USD, growth remains sluggish and there are little prospects of ECB tightening (today's press conference reiterates such a view). With EUR offering deeply negative implied yield (the second-lowest in the G10 space, after CHF) and little prospects of euro funding costs becoming less attractive (as the ECB should keep the policy accommodative), the euro should be used as the funding currency of choice for investors searching for yield in the undervalued emerging market FX world.

We look for a range-bound EUR/USD (1.10-1.15) next year, with clear downside risks.

[Read our 2020 FX Outlook: Diamonds in the rough](#)

EUR and UK election: Asymmetric reaction

As we highlighted in [GBP and UK election: Asymmetric sterling reaction](#), we expect the spillover from the today's UK parliamentary election outcomes into EUR/USD to (a) unlikely be long-lasting as Brexit is seen as a largely domestic even; and (b) likely to be asymmetric, with a muted reaction on a market-friendly outcome and a more pronounced reaction if the Conservative Party fails to achieve a majority or the elections result in a hung parliament.