EUR & the ECB: The good, boring funding currency

The uneventful European Central Bank meeting cemented the euro's position as an attractive funding currency. Those looking and/or hoping for signs of more imminent ECB policy normalisation were clearly disappointed. A stable EUR/USD converging towards the 1.1000 level is likely in the coming weeks and months

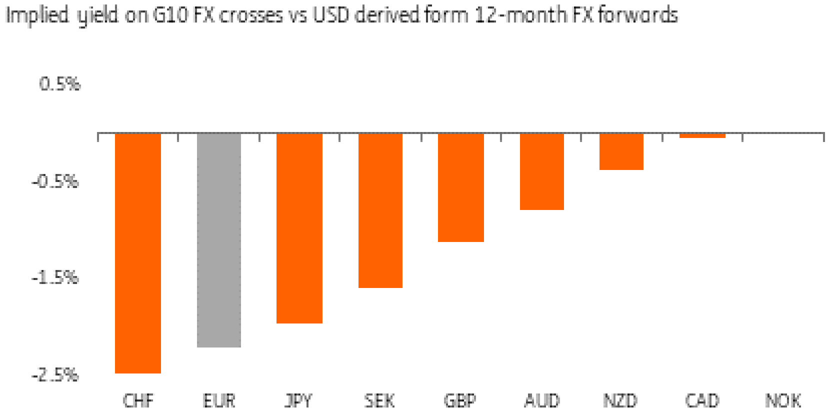
Uneventful ECB meeting and little sign of a policy shift

The euro modestly weakened in response to the fairly uneventful ECB meeting (see ECB Review: Wake me up before you review). While no new news has been revealed (in fact, President Christine Lagarde noted that incoming data points to some stabilisation in growth dynamics and mentioned indications of a moderate increase in underlying inflation), those who were looking for a more meaningful and imminent shift towards a less dovish policy stance have been disappointed. Although both the eurozone economic and inflation outlooks have been stabilising, such a path has always been the ECB base case. This suggests no urgent need to change the ECB policy stance despite some modestly better news. Hence, the modest dip in EUR/USD (in line with its compressed volatility of past quarters).

Euro's attractive funding characteristics intact

With few signs of an ECB policy reversal and deeply negative rates, the euro's attractive funding characteristics remain in place, with the euro to remain the funding currency of choice throughout 2020. Like the dollar, the euro is also highly liquid but unlike the dollar, it's cheap to sell it. As Figure 1 shows, the euro suffers from the second lowest / second most negative implied yield in the G10 FX space.

Figure 1: Euro operating with a deeply negative yield



Source: ING, Bloomberg

Flat EUR/USD profile

We continue to see a fairly high hurdle for a EUR/USD rally. The eurozone economic recovery will be very gradual and if it reaps some benefits from stabilising global growth (due in part to the US-China trade war truce) this will also have implications for the Federal Reserve (in the same way the Fed's easing last year did not occur in isolation). If downside risks evaporate and global trade picks up, the single Fed rate cut currently priced in by the market for 2020 is likely to be priced out. This would, in turn, benefit the dollar and limit the EUR/USD upside. We look for a fairly flat EUR/USD throughout this year. Our three-month forecast is 1.1000.