

EUR/USD: Playing catch-up with \$ crosses

The euro is enjoying a rally today as investors gauge the viability of plans for a €750 billion recovery fund created out of the EU's long-term budget. This EUR/USD move effectively sees the EUR playing catch-up with some other big rallies against the dollar. It's too early to say this is the start of a trend to 1.18/20, but it could turn into a 1.12 story for June



German Chancellor Angela Merkel, European Central Bank President Christine Lagarde, and European Council President Ursula von der Leyen

Source: Shutterstock

EUR plays catch-up

As we note in our [latest FX Talking](#), we've seen pockets of strength against the dollar over the last month. These have largely been confined to the high beta, pro-cyclical currencies. Those are NOK, SEK, AUD & NZD in the G10 space, and in the emerging markets space are currencies like MXN, COP, ZAR, BRL, and RUB. Clearly here the equity rally has helped – very much supported by the turnaround in energy markets. The low-yielding EUR, JPY, CHF have done little against the dollar, while Asian FX has taken on a fragile tone (e.g. USD/CNH at its highs) as Washington assesses its next steps against China.

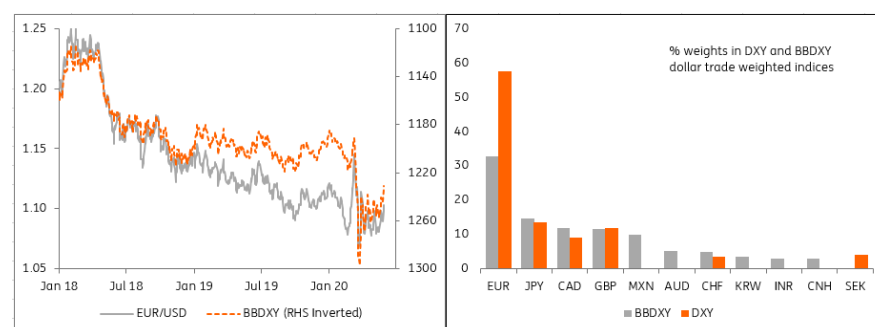
It is probably too early to say that today's rally in the EUR is the start of a major re-rating of

European risk. Certainly, the European Commission and its 'Next Generation EU' proposal would like that to be the case, but the path to getting a €750 billion recovery fund carved out of the long term EU budget will be a bumpy one, especially with EUR500bn of that fund allocated to grants. EU leaders will meet on 18/19 June to discuss these proposals in more detail and just like news on Covid-19 vaccines, there will be many highs and lows along the way. Thus it is hard to make the case that EUR/USD moves higher in a straight line from current levels.

We would say, however, if EUR/USD enjoys even a modicum of the re-rating stories enjoyed by some of the high beta currencies, 1.12 is achievable over coming weeks. This assumes that US-China does not completely derail the risk environment. We note as we write this that the AUD is under pressure on reports that China may impose coal import restrictions against Australia - again a risk our team highlighted in FX Talking.

In effect EUR/USD would just be catching up with the range breakout seen by one of the broader measures of the trade-weighted dollar, the Bloomberg Dollar Index (BBDXY). Unlike the heavily European weighted DXY dollar index, the BBDXY uses a broader number of trade weights based on trade and FX liquidity patterns. The big recoveries in currencies, like AUD, CAD, and MXN have seen the BBDXY decisively break lower and a modest EUR/USD rally would not be a surprise.

EUR/USD plays catch-up with weaker dollar index



Source: ING, Bloomberg

Broader dollar turn requires more confidence in EM

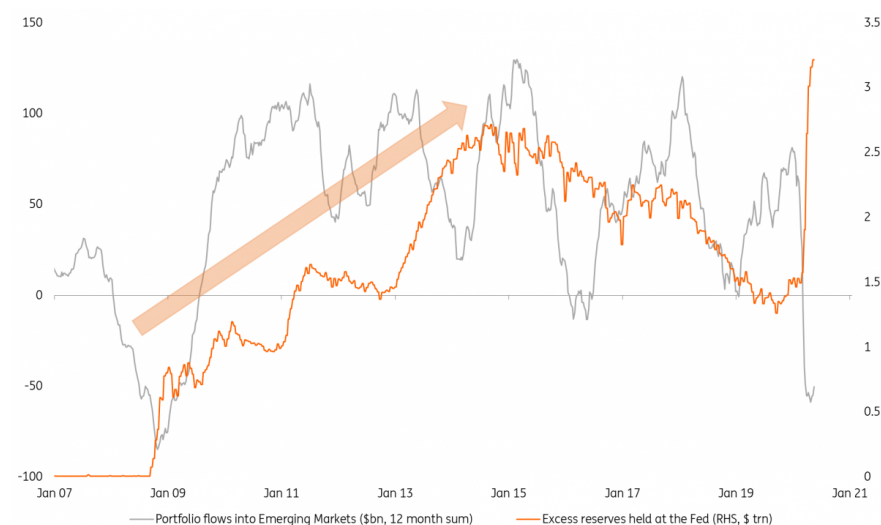
As noted above, this looks to be more of a series of re-rating stories, e.g. commodities and now Europe, as opposed to a broad turn in the dollar per se. What we would like to see is much more appetite for EM assets in general, which would help to dislodge conservative capital parked in the dollar and usher in a broader dollar decline.

We think that will happen – but it will take time. After Lehman's failure in September 2008, we did not see sustained portfolio inflows back into emerging markets until March 2009. And emerging markets, in general, were seen to be less affected by a financial crisis than they are by the global standstill in activity now.

Yet the flood of liquidity unleashed by the Fed, as we show below now in the form of excess USD reserves US banks have parked at the Fed, should mean that EM portfolio flows re-build again later this year. This benign environment, characterised by recovery and confidence rather than trade wars and division, should allow a broader dollar bear trend to emerge and is an integral part of our call for EUR/USD to end the year at 1.20.

There are many challenges to such a scenario, but at least the threat of an immediate rise in eurozone break-up risk is probably not one of them.

EM portfolio flows versus excess dollars held at Fed



Source: ING, IIF, Bloomberg

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.