

FX: Evaluating the scenarios

This July could prove to be a testing month for FX markets, given the rise in trade tensions



There's more value in outlining potential scenarios

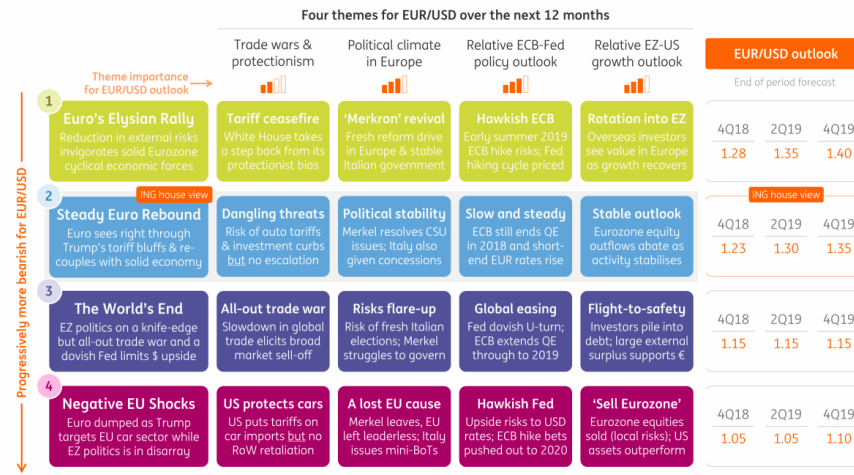
This is a particularly uncertain time for FX markets; where the escalation in the global trade war ends nobody knows. This makes a baseline FX scenario exceptionally difficult.

Rather than delivering back-to-back cuts in our baseline EUR/USD profile (despite mounting pressure in that direction) this month we believe there's more value in outlining potential scenarios. [Our full scenario analysis can be found here.](#)

Below we summarise four potential paths for EUR/USD into 2019, all supported by various assumptions for some of the key inputs, such as rate spreads and risk premia.

Four scenarios for EUR/USD into end 2019 (Click to enlarge)

The landscape for global markets is pretty murky but here are four potential EUR/USD paths



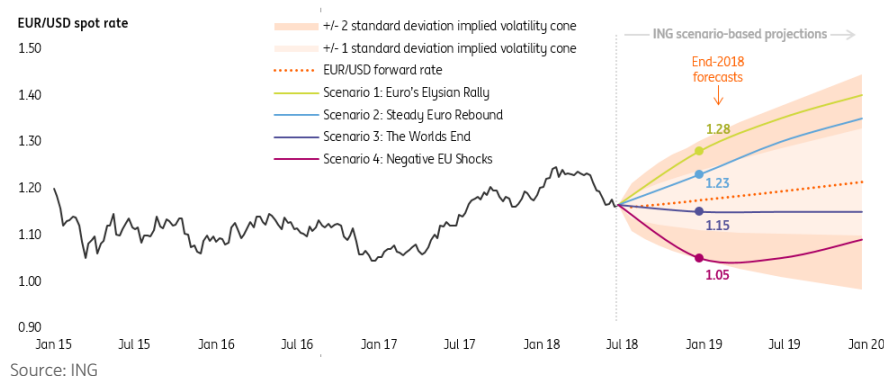
Source: ING

EUR/USD could potentially see 1.10 this summer

Compared to a tentative baseline of EUR/USD recovering to 1.23 by the end of the year, risks look clearly skewed to the downside. Were the Trump team to accelerate their review of auto imports and formally adopt the 20% tariffs on EU auto imports, we could potentially see 1.10 this summer. A scenario of 1.05 would, however, require: a) peak rate divergence where the US economy/Fed pricing is immune to rising trade tensions and b) peak pessimism on German and Italian politics.

It also remains a challenging time for EM FX. Slowing world trade and the Fed potentially taking policy into 'tight' territory could see the headwinds to EM turn into a hurricane.

EUR/USD spot rate projections



Source: ING

ING global forecasts

| | 2017 | | | | | 2018F | | | | | 2019F | | | | | 2020F | | | | |
|--------------------------------------|---------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|-------|-------|------|------|------|-------|
| | FIRST QUARTER | 2Q | 3Q | 4Q | FY | 1Q | 2Q | 3Q | 4Q | FY | 1Q | 2Q | 3Q | 4Q | FY | 1Q | 2Q | 3Q | 4Q | FY |
| United States | | | | | | | | | | | | | | | | | | | | |
| GDP (% QoQ, ann) | 1.2 | 3.1 | 3.2 | 2.9 | 2.3 | 2.0 | 4.0 | 3.3 | 2.3 | 2.9 | 1.5 | 2.2 | 2.0 | 1.9 | 2.2 | 1.7 | 1.8 | 1.8 | 1.7 | 1.8 |
| CPI headline (% YoY) | 2.6 | 1.9 | 2.0 | 2.1 | 2.1 | 2.3 | 2.7 | 2.9 | 2.6 | 2.6 | 2.3 | 2.4 | 2.4 | 2.3 | 2.3 | 2.3 | 2.2 | 2.1 | 1.9 | 2.1 |
| Federal Funds (% eop) ¹ | 0.75 | 1.00 | 1.00 | 1.25 | | 1.50 | 1.75 | 2.00 | 2.25 | | 2.50 | 2.50 | 2.75 | 2.75 | | 3.00 | 3.25 | 3.25 | 3.00 | |
| 3-month interest rate (% eop) | 1.15 | 1.30 | 1.33 | 1.56 | | 2.30 | 2.35 | 2.62 | 2.84 | | 3.04 | 2.99 | 3.27 | 3.30 | | 3.55 | 3.72 | 3.54 | 3.46 | |
| 10-year interest rate (% eop) | 2.40 | 2.30 | 2.30 | 2.40 | | 3.00 | 3.00 | 3.00 | 3.20 | | 3.30 | 3.20 | 3.20 | 3.20 | | 3.20 | 3.10 | 3.00 | 2.90 | |
| Fiscal balance (% of GDP) | | | | | -3.5 | | | | | -4.0 | | | | | -4.7 | | | | | -5.0 |
| Fiscal thrust (% of GDP) | | | | | 0.0 | | | | | 1.4 | | | | | 0.8 | | | | | 0.4 |
| Debt held by public (% of GDP) | | | | | 76.1 | | | | | 77.3 | | | | | 79.8 | | | | | 83.0 |
| Eurozone | | | | | | | | | | | | | | | | | | | | |
| GDP (% QoQ, ann) | 2.7 | 3.0 | 2.9 | 2.8 | 2.4 | 1.5 | 1.5 | 1.7 | 1.6 | 2.0 | 1.7 | 1.6 | 1.6 | 1.7 | 1.7 | 1.7 | 1.6 | 1.2 | 0.9 | 1.6 |
| CPI headline (% YoY) | 1.5 | 1.3 | 1.5 | 1.4 | 1.4 | 1.3 | 1.7 | 2.0 | 1.6 | 1.7 | 1.4 | 1.6 | 1.6 | 1.7 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Refi minimum bid rate (% eop) | 0.00 | 0.00 | 0.00 | 0.00 | | 0.00 | 0.00 | 0.00 | 0.00 | | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 |
| 3-month interest rate (% eop) | -0.33 | -0.33 | -0.33 | -0.33 | | -0.33 | -0.33 | -0.33 | -0.33 | | -0.25 | -0.20 | -0.10 | 0.10 | 0.10 | 0.15 | 0.30 | 0.40 | 0.50 | 0.50 |
| 10-year interest rate (% eop) | 0.45 | 0.40 | 0.45 | 0.42 | | 0.50 | 0.30 | 0.40 | 0.50 | | 0.60 | 0.70 | 0.70 | 0.80 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 |
| Fiscal balance (% of GDP) | | | | | -0.9 | | | | | -0.9 | | | | | -1.1 | | | | | -1.0 |
| Fiscal thrust (% of GDP) | | | | | 0.2 | | | | | 0.2 | | | | | 0.3 | | | | | 0.1 |
| Gross public debt/GDP (%) | | | | | 89.2 | | | | | 87.7 | | | | | 86.1 | | | | | 85.1 |
| Japan | | | | | | | | | | | | | | | | | | | | |
| GDP (% QoQ, ann) | 1.9 | 2.3 | 1.6 | 1.3 | 1.7 | -0.6 | 1.8 | 1.9 | 1.0 | 1.0 | 6.1 | -7.8 | 1.2 | 1.4 | 0.7 | 1.1 | 1.1 | 1.1 | 1.1 | 0.6 |
| CPI headline (% YoY) | 0.2 | 0.4 | 0.6 | 0.6 | 0.5 | 1.3 | 0.7 | 1.0 | 0.6 | 0.9 | 0.6 | 2.2 | 2.2 | 2.3 | 1.8 | 2.3 | 1.0 | 1.0 | 1.0 | 1.0 |
| Excess reserve rate (%) | -0.1 | -0.1 | -0.1 | -0.1 | | -0.1 | -0.1 | -0.1 | -0.1 | | -0.1 | -0.1 | -0.1 | 0.0 | | 0.0 | 0.0 | 0.0 | 0.0 | |
| 3-month interest rate (% eop) | 0.00 | 0.00 | 0.00 | 0.00 | | 0.00 | 0.00 | 0.00 | 0.00 | | 0.0 | 0.0 | 0.05 | 0.1 | | 0.1 | 0.1 | 0.1 | 0.1 | |
| 10-year interest rate (% eop) | 0.10 | 0.10 | 0.10 | 0.10 | | 0.10 | 0.10 | 0.10 | 0.10 | | 0.1 | 0.1 | 0.1 | 0.1 | | 0.2 | 0.2 | 0.2 | 0.3 | |
| Fiscal balance (% of GDP) | | | | | -4.8 | | | | | -4.1 | | | | | -3.6 | | | | | -3.0 |
| Gross public debt/GDP (%) | | | | | 221.0 | | | | | 223.0 | | | | | 224.0 | | | | | 226.0 |
| China | | | | | | | | | | | | | | | | | | | | |
| GDP (% YoY) | 6.9 | 6.9 | 6.8 | 6.8 | 6.9 | 6.8 | 6.7 | 6.7 | 6.8 | 6.8 | 6.7 | 6.7 | 6.6 | 6.6 | 6.7 | 6.6 | 6.5 | 6.5 | 6.4 | 6.5 |
| CPI headline (% YoY) | 1.4 | 1.4 | 1.6 | 1.8 | 1.6 | 2.5 | 2.0 | 2.0 | 2.1 | 2.2 | 1.9 | 1.9 | 1.9 | 2.0 | 1.9 | 2.0 | 1.9 | 1.8 | 1.7 | 2.0 |
| PBOC 7-day reverse repo rate (% eop) | 2.45 | 2.45 | 2.45 | 2.50 | | 2.55 | 2.55 | 2.55 | 2.55 | 2.55 | 2.55 | 2.60 | 2.65 | 2.70 | 2.70 | 2.70 | 2.70 | 2.70 | 2.75 | 2.75 |
| 10-year T-bond yield (% eop) | 3.29 | 3.57 | 3.61 | 3.90 | | 3.75 | 3.54 | 3.50 | 3.40 | 3.40 | 3.30 | 3.20 | 3.10 | 3.00 | 3.00 | 3.00 | 2.95 | 2.95 | 2.90 | 2.90 |
| Fiscal balance (% of GDP) | | | | | -3.7 | | | | | -3.5 | | | | | -3.5 | | | | | -3.5 |
| Public debt, inc local govt (% GDP) | | | | | 50.0 | | | | | 85.0 | | | | | 100 | | | | | 100 |
| UK | | | | | | | | | | | | | | | | | | | | |
| GDP (% QoQ, ann) | 1.3 | 1.0 | 1.9 | 1.6 | 1.5 | 0.9 | 1.9 | 1.5 | 1.8 | | 1.5 | 1.4 | 2.3 | 1.7 | | 2.1 | 1.7 | 1.7 | 1.7 | |
| CPI headline (% YoY) | 2.1 | 2.7 | 2.8 | 3.0 | 2.7 | 2.7 | 2.5 | 2.5 | 2.3 | 2.5 | 2.2 | 2.1 | 1.9 | 2.0 | 2.0 | 2.1 | 2.2 | 2.2 | 2.1 | 2.2 |
| BoE official bank rate (% eop) | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.25 | 1.50 | 1.50 | 1.50 |
| BoE Quantitative Easing (Ebn) | 445 | 445 | 445 | 445 | | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 | 445 |
| 3-month interest rate (% eop) | 0.35 | 0.35 | 0.35 | 0.52 | | 0.60 | 0.80 | 0.80 | 0.80 | 0.80 | 0.85 | 1.05 | 1.05 | 1.05 | 1.05 | 1.30 | 1.35 | 1.60 | 1.65 | 1.65 |
| 10-year interest rate (% eop) | 1.15 | 1.10 | 1.35 | 1.20 | | 1.45 | 1.48 | 1.70 | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.0 | 2.1 | 2.2 | 2.2 | 2.2 | 2.2 |
| Fiscal balance (% of GDP) | | | | | -2.5 | | | | | -1.8 | | | | | -1.7 | | | | | -1.4 |
| Fiscal thrust (% of GDP) | | | | | -0.5 | | | | | -0.4 | | | | | -0.4 | | | | | -0.3 |
| Gross public debt/GDP (%) | | | | | 87.0 | | | | | 86.5 | | | | | 86.0 | | | | | 85.5 |
| EUR/USD (eop) | 1.08 | 1.12 | 1.20 | 1.20 | | 1.25 | 1.17 | 1.17 | 1.23 | | 1.25 | 1.30 | 1.33 | 1.35 | | 1.36 | 1.37 | 1.38 | 1.40 | |
| USD/JPY (eop) | 112 | 115 | 110 | 113 | | 107 | 110 | 110 | 110 | | 108 | 105 | 102 | 100 | | 98.0 | 95.0 | 93.0 | 90.0 | |
| USD/CNY (eop) | 6.89 | 6.78 | 6.65 | 6.51 | | 6.28 | 6.67 | 6.80 | 7.00 | | 7.00 | 6.80 | 6.60 | 6.50 | | 6.5 | 6.4 | 6.4 | 6.3 | |
| EUR/GBP (eop) | 0.87 | 0.88 | 0.94 | 0.89 | | 0.88 | 0.88 | 0.88 | 0.86 | | 0.83 | 0.82 | 0.81 | 0.80 | | 0.8 | 0.8 | 0.8 | 0.8 | |
| Brent Crude (US\$/bbl, avg) | 55 | 51 | 52 | 61 | 55 | 67 | 72 | 70 | 68 | 69 | 64 | 66 | 67 | 66 | 66 | 61.0 | 66.0 | 71.0 | 66.0 | 66.0 |

¹Lower level of 25bp range; 3-month interest rate forecast based on interbank rates
Source: ING forecasts

Source: ING Global Research

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