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FX

FX implications of the EU Summit

With plenty of good news priced into euro ahead of the EU summit, the reaction to the agreement today was limited. Yet, we don't expect a "sell the fact" response, look for stable EUR/USD this week and more gains to 1.20 later this year as USD weakness kicks in. European FX to benefit. We like Scandinavian currencies and expect GBP to remain the laggard



EUR: Good news priced in but no reason to “sell the fact”

The euro's reaction to the agreement on the EU recovery fund and the EU budget ([see EU Summit for details](#)) was quite muted overnight and this morning largely because optimism about a deal had been priced into the euro since the start of the last week. While we don't think the currency reaction will fully reflect “buy the rumour, sell the fact” mechanics, its near term upside above 1.15 is likely to be limited as good news has been priced in already. But equally, the agreement is significant enough (the emergence of grants points to solidarity; the emergence of common bonds points to integration) not to prompt investors to exit their long EUR positions (particularly against USD, where the outlook for the remainder of the year looks bleak).

With the EUR-specific good news now being largely in the price, we expect the next leg of the EUR/USD upside to come from the dollar side, with the US currency's downtrend caused by a combination of loose monetary policy from the Federal Reserve (note the dollar lost its key

advantage which has kept it supported in prior years - the meaningful interest rate differential), the twin deficit and the US Presidential election uncertainty. We see EUR/USD moving to 1.20 by year-end.

Scandinavia FX benefiting

With EUR/USD rising ahead of the summit and the EU deal (both on the recovery fund and EU budget) reducing downside risk to the eurozone's economic outlook and compressing the region's fiscal risk premium, this is a positive for other European currencies such as Norway's krone and Sweden's krona. The two cyclical currencies are set to feel a positive spillover from higher EUR/USD and improved risk sentiment while both still screen as undervalued vs the euro based on our medium-term BEER valuation framework. We expect both EUR/SEK and EUR/NOK to reach the 10.00 level by the year-end and NOK/SEK to move to parity.

Limited gains for sterling

Although sterling reacted positively yesterday, we see limited scope for EUR/GBP to persistently break below the 0.90 level this summer. Sterling should remain a laggard among European FX, with the UK-EU trade negotiations overhang being the key obstacle for persistent GBP gains this summer. Note that we don't expect any real progress in negotiations this summer and look for the process to drag on into the late third quarter and early fourth quarter of this year. Also, as discussed previously, GBP sensitivity to risk appetite has changed since the Brexit referendum, with sterling suffering disproportionately more in falling markets than it benefits from rising markets (see [GBP: The ongoing disappointment](#))

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