

The fully justified ECB concerns about a euro overshoot

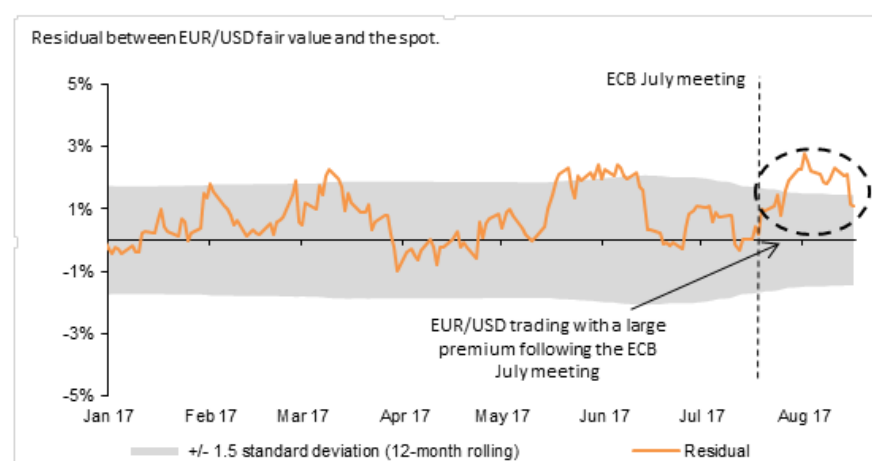
We fully share the ECB concerns about the risk of a high euro



Today's European Central Bank Minutes point to a likely cautious ECB approach to QE tapering. While there is no doubt that tapering is coming, as long as the journey reflects cautious and careful baby steps towards the end game, the ECB may indeed materially decrease the risk of EUR overshooting – the concern / key theme that grabbed the headlines following the publications of ECB Minutes today. Read the background [here](#):

We fully share the ECB concerns about the risk of EUR overshooting. In fact, we believe that since the 20 July ECB meeting (for which today's minutes provide an account), the EUR/USD started heavily overshooting, with the moves above the 1.1500 level (which was the level prior to the ECB July press conference) being unjustified - in turn realising the ECB fears about the unwanted overshoot. Indeed, as Figure 1 shows, EUR/USD started persistently trading above its short-term fair value (which we estimate to be at EUR/USD 1.15) . The fact that the EUR/USD rally of past weeks above the 1.15 level was accompanied by decreasing bund yields provide a case in point that the cross indeed overshoot and is in line with our view of "EUR madness" expressed in the [Global Monthly Economic Update](#).

Residual between EUR/USD fair value and the spot



All-in-all, the tone of the minutes suggests that the ECB will indeed be cautious about the way it will communicate/move towards the upcoming QE tapering, with the dovish form of QE tapering being the most likely option. This suggests that a material upside to long dated bund yields should be limited in the coming months (particularly if we have Italian elections in Q1 2018), which in turn means a limited upside to EUR/USD (unless we see a discrete USD weakness). This is in line with our view that EUR/USD should remain flat / range trade around current levels in coming months and only start persistently moving higher / above the EUR/USD 1.20 level from Q2 2018 onwards as (a) Italian elections will be out the way; (b) the ECB will be approaching the end of the QE tapering; and (c) the forward looking market participants start prepositioning for the ECB depo rate normalization.