Why we're bullish on the Euro

Our latest developed market FX views and forecasts

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EUR/USD: Trading the taper

EUR/USD is starting to trade consistently above levels typically associated with short term interest rate spreads. We attribute that to speculation of ECB tapering this summer. We think the ECB will have to provide updates on the PSPP scheme either at its 20 July meeting or more likely its 7 September meeting. We have a baseline view that Bund yields break higher in 3Q17, carrying EUR/$ to 1.15.

In the US, rates and ineffective Trump policy are holding the dollar back. On rates, there is a huge gulf between market pricing of Fed Funds at end 2018 (+40bp) versus Fed Dot Plots (+100bp). The balance of risks to US activity/inflation points to the Fed moving to the market – and not vice versa. This is neutral/negative for USD.

European political risk has ebbed, but Italian elections in 1Q18 may restrain EUR/USD strength – delaying the 1.20 story until 2Q18.

1.20 12-month EUR/USD forecast

USD/JPY: Shackled to the US long bond

USD/JPY continues to trade tightly with US ten year Treasury yields. We tend to think the latter could be finding a base in the 2.10/15% area and particularly by the end of 3Q17 look for yields to have picked up to the 2.50% area. This may owe largely to passage of some modest reflationary fiscal policy ahead of the new US fiscal year (starting in October) and some modestly better US activity data. A break-out in US price pressure looks uncertain.

Thus if there is any further cyclical dollar strength to be seen, we believe it will be seen largely in USD/JPY.

In Japan, activity is quietly picking-up and the BoJ is of the view that a 'virtuous circle' is in place. Yet a large output gap and inflation at 0% versus a target of 2%+ will keep the BoJ at the back of the pack when it comes to normalising policy.

118 12-month USD/JPY forecast

GBP/USD: Cheap, but cheap for a reason

GBP is softer on the back of a disastrous UK election performance by the ruling Conservatives. Having lost their majority, the Tories now rely on 10 Northern Irish DUP members to pass key votes – the first of which will be the vote on the Queen's Speech (the government's planned legislation) on Wednesday, 21 June. While Theresa May's Hard Brexit has been rejected by the electorate, securing a soft Brexit, or securing any legislation whatsoever looks very challenging with this very weak government.

The fact that GBP has not fallen further largely owes to GBP undervaluation (around 25% versus USD) and one of the key reasons we think Cable will bounce back later this year.

Yet the UK economy looks weak (full year growth 1.5%) and we think the 3 external MPC members voting for a hike should be ignored.

1.41 12-month GBP/USD forecast

EUR/JPY: 130 here we come!

EUR/JPY is staying quite bid despite a variety of geo-political challenges. We retain a high conviction view that EUR/JPY is about to embark on a major bull trend – largely on the back of a view that the world economy is recovering and that the normalisation of central bank monetary policy will be a key theme. For 2H17, we think that ECB policy normalisation will trigger a break-out in Bund yields – probably lifting US yields in the process. At the back of the pack will be the BoJ, who should keep JGB yields stable near 0% into year-end.

There is also the prospect that France and Germany could push for stronger Eurozone integration after German elections in Sep.

We compare the current environment to 2005-2007 – where synchronised global growth & ECB hikes helped EUR/JPY higher

142 12-month EUR/JPY forecast

EUR/GBP: 0.8800/0.9000 looks the top of range - but many risks

EUR/GBP has once again met resistance over 0.88, despite a collection of GBP negatives building – particularly a weakened government that may not be able to deliver anything. Indeed, well-intentioned calls for a cross-party approach to Brexit look naïve – with both Labour and the Conservatives unlikely to reach compromise. Labour looks more focused on bringing down the Tory government – and early elections, or at the very least a new Conservative leader, look likely this summer.

The GBP bull case relies on a) GBP being undervalued (we agree), b) a government being able to deliver a softer Brexit (very uncertain at this stage).

A strong EUR in 3Q17 should see EUR/GBP test 0.88/0.90 – and an uncertain political outlook favours high GBP hedge ratios.

0.85 12-month EUR/GBP forecast

EUR/CHF: Sluggish reaction to reduced EZ political risk

The removal of French Presidential risk has been greeted by EUR/CHF with a move back to levels seen last October. We would expect some of this year's safe haven purchases of CHF to soon reverse. SNB data show that foreigners acquired an extra CHF20bn in CHF sight deposits in the first 3 months of this year. It would be no surprise to see it unwind.

Domestically the SNB are still focusing on spare capacity and inflation not sustainably moving above 1% until 2019. We suspect the SNB will eagerly await the ECB tapering debate – and having chosen to abandon the floor in the face of forthcoming ECB QE in early 2015, will be expecting a EUR/CHF rally on ECB tapering.

Italian elections will prove a risk in 1Q18, but for the rest of 2017 we see momentum behind EUR/CHF and are raising our forecasts.

1.12 12-month EUR/CHF forecast

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