

## The euro may need to cheapen a little more

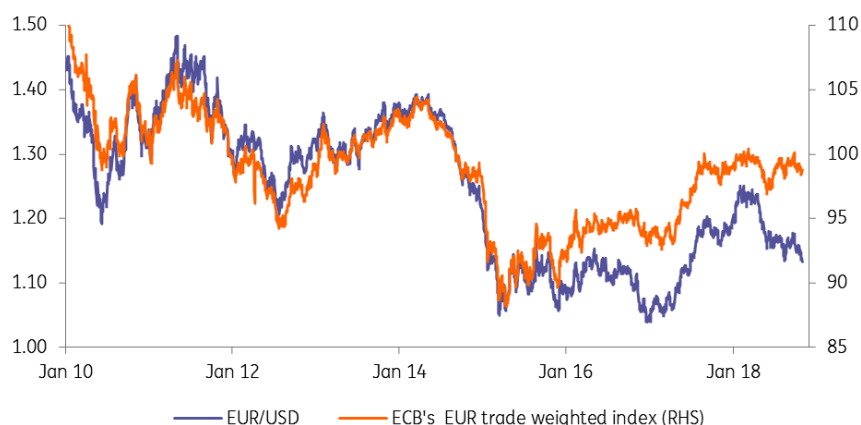
EUR/USD is close to the lows of the year, largely as a result of widespread dollar strength. The EUR trade-weighted index is not far from cyclical highs, largely due to weakness in the Chinese yuan and British pound. Neither investors nor corporates may think the EUR is especially cheap at the moment, suggesting it may need to drop some more



### How weak is the EUR?

While EUR/USD is very close to the lows of the year, the EUR trade-weighted index is not. This is a result of the large weights given to the Chinese Renminbi (23%) and GBP (13%), both of which are suffering on politics and trade concerns. The dollar holds a 17% weighting in the ECB's trade-weighted EUR index, with the divergence of the dollar driving a wedge between EUR/USD and the EUR trade-weighted both in 2016 and 2018.

## EUR/USD weak, EUR trade-weighted less so



Source: ING, Bloomberg

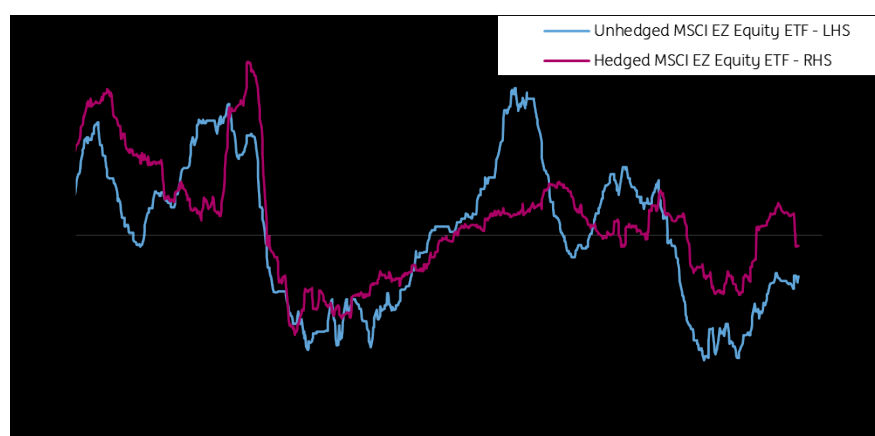
## Eurozone growth disappoints, investors lukewarm

De-synchronised global growth is very much the story of 2018. The US fiscal/monetary policy mix has delivered strong US outperformance, while eurozone growth has disappointed. An important factor in any EUR/USD recovery story will be growth differentials and what they mean for international portfolio flows – particularly equity flows. The US has delivered strong growth in both 2Q and 3Q 2018. The 6 November US mid-term elections will have a say in whether this fiscally-powered growth extends into 2019.

The most recent eurozone growth figures have disappointed, with 3Q18 growth at 0.2% quarter-on-quarter – a far cry from the 0.7% QoQ readings seen since last year. [Our team believes](#) that local political uncertainty may be weighing on investment trends, higher oil prices are hitting consumption and the open economy of Europe is suffering, as world trade slows. These trends are showing no signs of slowing.

For investors, the uncertain eurozone growth outlook raises doubts about rotating away from US equities (peak US corporate earnings?) and into Europe. We've updated one of our favourite charts below showing flows into iShares Eurozone Exchange Traded Funds (ETF) – tracking flows into both the non-FX-hedged and the FX-hedged ETF product. Compared to the surge in demand for unhedged eurozone equities last summer, 2018 has only seen lukewarm demand for FX-hedged exposure to eurozone equities – and even that has reversed recently.

## Demand for Eurozone equities wanes



Source: ING, Bloomberg

## European corporates may wait for a weaker EUR/USD

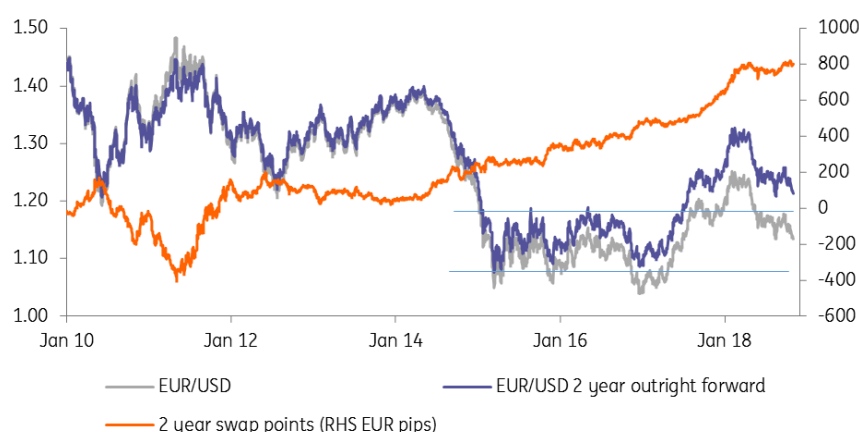
One of the major supporting factors for EUR/USD is the eurozone's large current account surplus, near 4% of GDP. And despite President Trump's protectionist push, tax cuts will only widen, not narrow the US trade deficit – presenting a greater supply of dollars on the trade account.

Near 1.13, EUR/USD also looks historically cheap. But when hedging USD receivables, European corporates take a longer-term view and the shape of the forward curve plays a significant role.

The current interest rate differential between the EUR and USD in the two-year part of the curve has never been wider than it is today at 330 basis points. That converts into 800 EUR pips in the FX forward market, meaning that the two-year outright forward near 1.22 is far more expensive than EUR/USD spot levels would suggest. European corporates in the market to sell their expected USD receivables two years forward (as many do) may not see the EUR/USD as especially cheap compared to the 1.08-1.18 levels that prevailed in the 2015-2017 period.

US mid-terms will have an important say in the dollar story for 2019. But the EUR story does not look especially encouraging right now and we are more worried by a potential break under 1.10 than we are by a move over 1.18.

## EUR/USD not so cheap in the FX forward market



Source: ING, Bloomberg

## Author

### Chris Turner

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

[chris.turner@ing.com](mailto: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](http://www.ing.com).