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Article

EUR/USD: What's next?

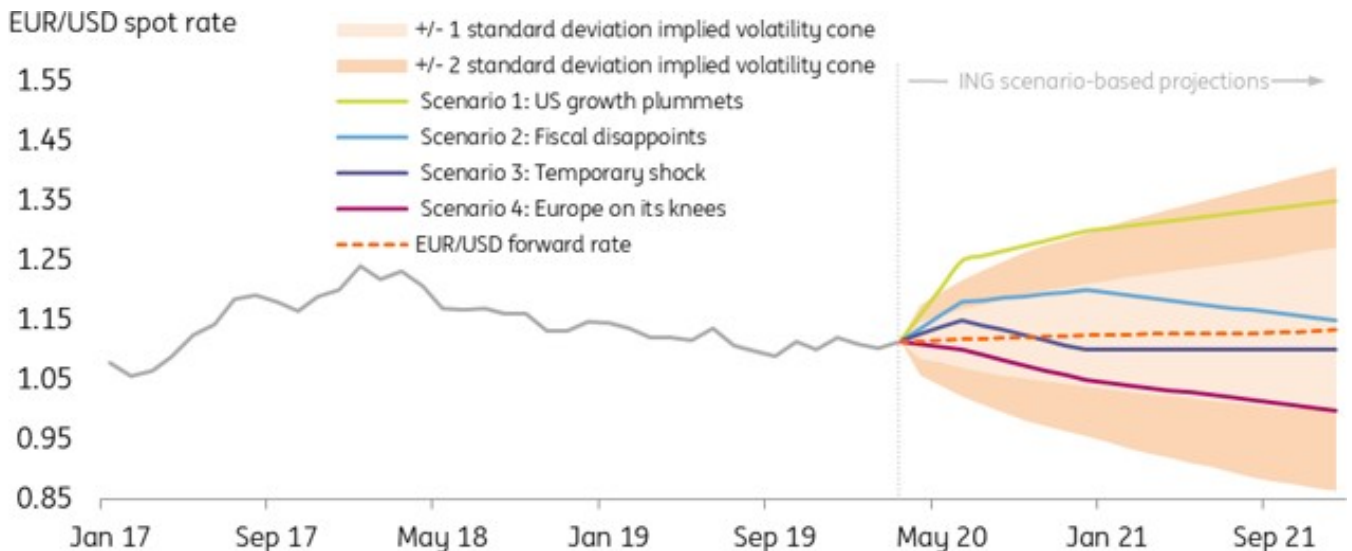
With global uncertainty rising and EUR/USD volatility increasing, the game has changed for the cross. We look at various scenarios for the likely future EUR/USD path

The global markets landscape is highly uncertain but here are four potential EUR/USD paths

Four themes for EUR/USD over the next two years

	Covid-19 real sector impact	Central bank response	Fiscal response	Political fall-out	EUR/USD outlook
1 US growth plummets ... and the need to deliver large scale Fed easing sends USD lower Theme importance for EUR/USD outlook →	Global shock, US goes into two quarters of recession, US growth converges to that of the EZ	Fed restarts QE at US\$50bn per month, mainly treasuries. ECB APP scheme maxed out	Congress discord means US slow to respond. Surprising EZ co-ordinated fiscal stimulus of 0.8% of GDP	Biden wins election, less aggressive global trade policy helps slow recovery in RoW currencies	End of period forecast 2Q20: 1.25 4Q20: 1.30 4Q21: 1.35
2 Fiscal disappoints As central banks need to step in for governments, Fed's larger fire power vs ECB keeps USD soft	Dim US growth prospects prompt Fed to undertake limited QE. Two quarters of recession in the EZ	Modest 6m Fed QE keeps USD weak, ECB modest APP increase (extra EUR10bn pm) no game changer	Fiscal responses generally underwhelm, leaving modest Fed QE as the dominant theme	Slow US growth helps Biden win. Mild USD negative, but lack of EZ leadership in 2021 reverses EUR gains.	2Q20: 1.18 4Q20: 1.20 4Q21: 1.15
3 Temporary shock The eventual reversal of the Fed rate cuts in 2021 would cause USD rebound	Temporary shock sees just one quarter of negative US growth, EZ sees two quarters	Having cut rates 100bp in 1Q20 (but no QE), Fed reverses all in 2021. ECB depo rates near -0.50%	Well-received fiscal measures (especially from the US), leave the Fed in a position to normalise policy.	V-shaped US recovery especially in stock markets see Trump win and focus on Trade War 2.0 starting in 2021	2Q20: 1.15 4Q20: 1.10 4Q21: 1.10
4 Europe on its knees EZ economy being left behind and ECB doing all heavy lifting again sending EUR lower	Severe fall-out in West. Europe, no engines of growth, Japanification fears. Impressive US fiscal response	Fed avoids QE given UST yields near 0. ECB scales up APP to EUR50bn p.m., expanding eligible asset base	German vote in '21 obstructs fiscal response, political division rise. In US, bipartisan payroll tax cut of \$200bn+	Weak growth and tepid EZ response triggers political fragmentation. Italian banks crisis threatens EZ	2Q20: 1.10 4Q20: 1.05 4Q21: 1.00

Source: ING



Source: ING, Bloomberg.

Scenario analysis based on four macro & political themes

Four factors stand out as key EUR/USD drivers over the next one to two years. These are: (i) Impact of Covid-19 on the real sector; (ii) Central banks response; (iii) Fiscal response; (iv) Politics. Above we outline our baseline and alternative assumptions for these inputs – and the corresponding EUR/USD profiles. As a base case we are now split between scenario 2 and scenario 3.

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