

FX Strategy

ECB introduces 'easing risk premium' on EUR

- A very dovish tone from the ECB today removes key driver for EUR/USD upside
- As a result we lower our EUR/USD and EUR/CHF forecast profiles markedly
- We now see very limited upside in EUR/USD and merely target 1.17 in 12M

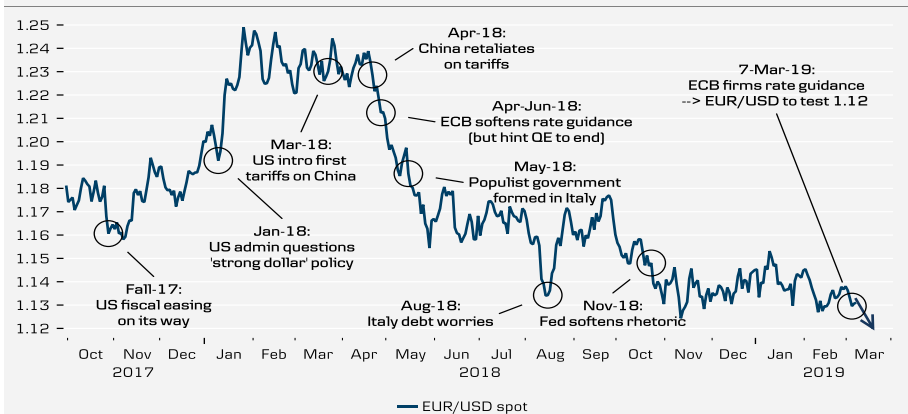
ECB removes key driver for EUR/USD upside this year

The ECB took us by surprise today, as the expectation of a 2019 hike was a pillar of our bullish EUR/USD view this year. In light of the very soft ECB message, the drop in EUR/USD from just above the 1.13 mark before the announcement to briefly below 1.1250 was not as large as this significantly dovish package warrants, in our view. Indeed, we would expect to see the cross slide further in coming days. We no longer see an ECB hike on a 12M horizon, see our *ECB review*, 7 March 2019, and update our FX view accordingly.

We previously stressed that the prospects of an end to the ECB-Fed policy divergence this year held the potential for a sustained uptick in EUR/USD towards the end of the year, i.e. that an end to Fed hikes, a US-China trade deal and a first ECB hike would, in combination, take the cross towards 1.25 in 12M. The latter is now taken out of the equation with this not in sight on a 12M horizon. Indeed, today's ECB communication highlights that all policy options are back on the table and - crucially for the FX market - this opens up the range of possible policy outcomes and introduces an 'ECB easing risk premium'. Importantly, it also postpones the potential for a capital-flow reversal to support the EUR as negative rates will reign in the euro zone for some time still. That said, valuation still holds a hand under EUR/USD and a US-China trade deal with positive spill-over to Europe remains a medium-term positive.

Consequently, we are changing our EUR/USD and EUR/CHF forecast profiles, which is where we see the greatest impact from our change in the ECB call to reflect that we now see very limited upside potential in these crosses this year.

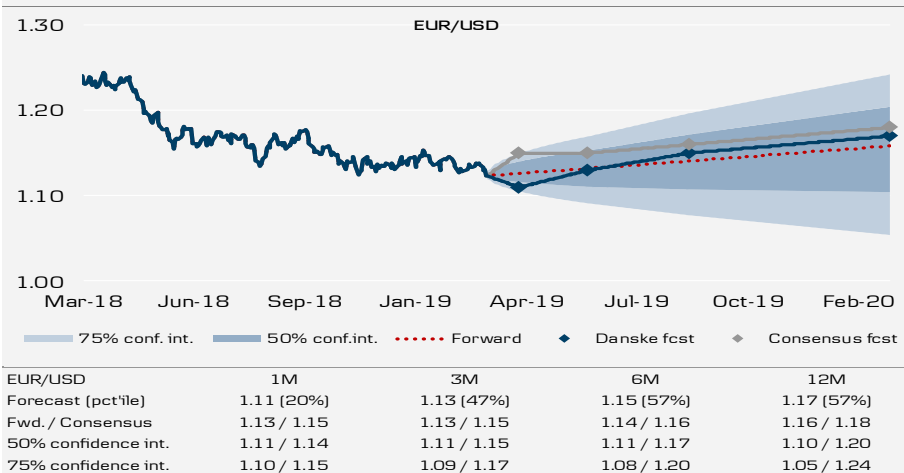
Chart 1. EUR/USD and significant events since late 2017



Source: Bloomberg, Danske Bank

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Chart 2. EUR/USD forecast profile lowered



Source: Bloomberg, Danske Bank

Forecasts lowered: limited upside in EUR/USD and EUR/CHF

Near term, we expect EUR/USD to drift below the 1.12 mark – watch out for 1.1216 (2018 low) resistance and 1.1179 (27 June 2017 low) thereafter. With the risk of pockets of USD-strength from renewed pricing of Fed hikes and a trade deal that will not provide much imminent support, this opens the possibility for a EUR/USD move towards 1.10 on a 3M horizon, see Chart 1. In the medium term (3-6M out) we expect EUR/USD to stabilise and move back into the 1.12-1.16 range and stress that any drift higher will be limited with any upside mainly deriving from positive spill-over to the euro area from a turn in the global (China) cycle.

As a result, we are changing our EUR/USD forecast to 1.11 in 1M, 1.13 in 3M (previously 1.15), 1.15 in 6M (previously 1.20) and 1.17 in 12M (previously 1.25), see Chart 2. This is a marked change in our EUR/USD outlook and we emphasise that it should be seen as a EUR/USD that is effectively left without much of a trend this year. In the same vein, we also update our EUR/CHF profile, as the SNB remains a derivative of the ECB: even if political risks are set to clear in Europe in H1, we see limited upside potential in EUR/CHF, as SNB will remain stuck with weak inflation pressure and hence negative rates. We project EUR/CHF at 1.13 in 1M, 1.14 in 3M (previously 1.15), 1.15 in 6M (previously 1.18) and 1.17 in 12M (previously 1.20). Our other FX forecasts are also under review and will be updated mid-month as usual.

In light of the high carry on long EUR/USD positions and the fact that our forecast is now slightly below forwards, we advise EUR- and Scandi-based clients to consider e.g. risk reversal for hedging USD income/assets.

From our *FX Top Trades 2019*, 4 December 2018, we remain long USD carry basket (versus SEK, JPY, CHF) and while acknowledging that potential is now seen as markedly lower in EUR/USD, we keep our bullish option strategy in the cross (effectively now a 6M call, strike at 1.1475), see Table 1.

Table 1. Danske FX Top Trades 2019 - open trades

Open Top Trades						
#	Trade	Opened	Entry	Closed	Current	PnL
2	Long NOK/SEK spot outright	03/12/18	1.0569		1.0782	2.39%
3	Long EUR/USD via 9M 1.1475 call financed by sold 3M 1.1200 straddle	03/12/18	1.1334		1.1235	-0.30%
4	Long USD carry basket vs JPY, SEK, CHF	03/12/18	100.00		101.99	1.99%

Source: Bloomberg, Danske Bank

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Expected updates

Ad hoc

Date of first publication

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