Eurozone – Economy & Euro

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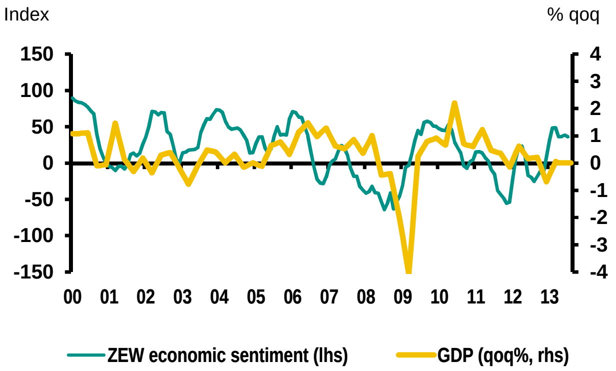
Economy

It was a quiet week in terms of economic data, with the German ZEW-indicator being the most important data release. The index unexpectedly fell to 36.3 in July, down from 38.5 in June (consensus: 40). The index gauges the opinion of financial analysts about economic conditions in Germany in the coming six months and is relatively sensible to changes in market sentiment. Therefore, recent volatility on financial markets probably had a negative impact. Overall, the index has now moved sideways since April, and the outcome does not change our view that the German economy will have grown solidly in the second quarter, which has recently also been noted by the finance ministry and the Bundesbank. Looking forward, we expect the country to continue to be the star performer in the Eurozone. Improving global economic conditions should foster German exports, while gains in real wages, low unemployment and neutral fiscal policy should support domestic spending.

ZEW-indicator and GDP growth

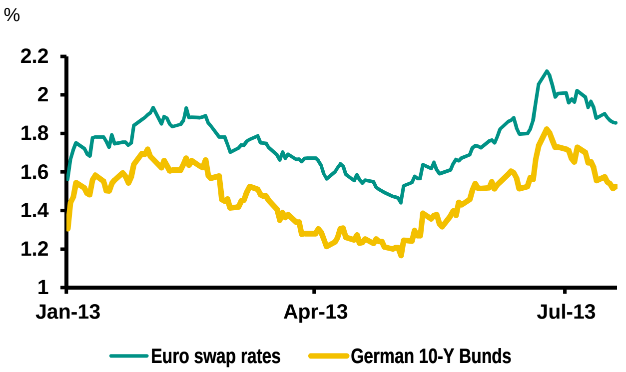


Source: Thomson Reuters Datastream

Interest rates

Last week, yields on the benchmark 10-Y Bund ended the week roughly 3 bp lower at 1.53%, while 10-Y euro swap rates dropped by 2bps to 1.86%. The drop was mainly related to semi-annual testimony of Fed-Chairman Bernanke, which was more dovish than expected, also leaving its mark on interest rates in the eurozone. Looking forward, we think that bond yields in the (semi) core eurozone countries and swap rates will face a tug of war between a dovish ECB on the one hand, and better economic data and Fed tapering on the other. This is likely to keep rates hovering at current levels, though we do expect a gradual rise in yields later in the year, with further significant rises next year. Improving investor sentiment should see peripheral spreads narrowing. Meanwhile, the ECB announced changes to haircuts applied for securities eligible in its monetary policy operations, which generally favoured asset-backed securities (ABS). It also noted that it continues looking for ways to improve SME funding conditions, mentioning a possible acceptance of SME-backed ABS loans.

Government bond yields and euro swap rates

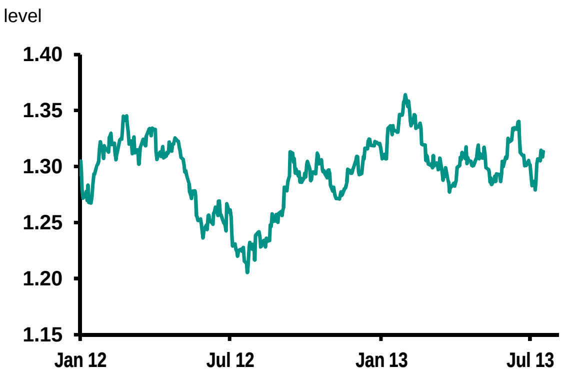


Source: Thomson Reuters Datastream

EUR/USD

At the start of the week, EUR/USD edged higher, as the market was positioning itself for a dovish sounding Fed Chairman Bernanke. He did not disappoint on this front. As this was priced in though, the USD recovered, despite the weaker-than-expected US housing data. Meanwhile, stronger US data such as lower jobless claims helped the USD to recover, resulting in some pressure on EUR/USD. All in all, EUR/USD remained in the 1.30-1.32 range during the week. This week the US data calendar is light and will unlikely be a driver for EUR/USD, though the release of US durable orders could result in intraday volatility. In the eurozone the purchasing manufacturing indices and German Ifo will be released. If they come in above market consensus, EUR/USD should rise a bit. Overall, we do not expect large directional moves in EUR/USD this week. However, US data should soon start to improve and we therefore expect EUR/USD to start moving towards our target of 1.25 for Q3 2013 in coming months.

EUR/USD



Source: Thomson Reuters Datastream

Europe - FX

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GBP

EUR/GBP

level

Source: Bloomberg

Last Tuesday, inflation numbers came in lower-than-expected, which resulted in expectations that the BoE may ease monetary policy further or will keep monetary policy loose for longer. Consequently, the sterling came under pressure and EUR/GBP rallied towards 0.87. However, these expectations were curbed on Wednesday when the BoE´s July meeting minutes were released. These showed that the MPC was united in its decision to keep monetary policy unchanged at the first meeting chaired by Governor Carney (the first time since October that the MPC was unanimous in its voting on QE). Meanwhile, the minutes revealed that the MPC favours forward guidance as a mean to steer monetary policy expectations. Overall, it seems that more asset purchases are off the cards, and that the MPC will start implementing, like other main central banks, more detailed forward guidance as a policy tool. As a result, the GBP recovered again, ending the week slightly stronger versus the euro. Looking forward, we expect a further modest strengthening of sterling versus the euro.

SEK

EUR/SEK

Level

Source: Bloomberg

Last week, the Riksbank released the minutes of its 2 July meeting when it left interest rates on hold at 1.0%. They state that the high levels of debt among Swedish households were seen as making the economy more vulnerable to shocks. The majority of the Executive Board considered that the current repo-rate path was a reasonable balance between inflation and the real economy stabilizing more in the short-run, and more long-term risks related to household debt. The minutes were seen less dovish as expected, as the strength of the Swedish krona (SEK) was not mentioned. Moreover, the discussion about household debt, to us, suggests that a rate cut is not very likely this year. Accordingly, after the release of the minutes, the SEK recovered strongly. This week household lending, confidence data, producer inflation, employment data and trade balance will be released. If they come in above expectations, we expect the recovery of the SEK to continue. We keep our Q3 target for EUR/SEK of 8.25 in place.