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Will the euro dip last?

Global FX: EUR/USD correction on its way – Since the end of August, the EUR/USD exchange rate has moved several times above the 1.20 level. However, on each occasion, the pair has been unable to maintain those levels. We think that the excessive net-long euro positions in the futures market are responsible for this. Speculative investors are already positioned for euro strength, so there is an absence of new buying to push EUR/USD higher. Moreover, as EUR/USD failed to stay above 1.20, some investors may have become nervous and have taken profit on some of their euro longs. Some others wait for a rally towards 1.20 again to take profit. If the correction in EUR/USD continues, they will probably take profit at lower levels and this will accelerate the overall correction in EUR/USD. A part of this process is that investors have become receptive again for (even modestly) less favourable eurozone news such as the result of the German elections and weaker than expected German Ifo business climate indicator on Monday. We expect the correction in EUR/USD to continue for the coming days and weeks. The move could be accelerated by more hawkish-than-expected comments from Fed officials this week. Overall, we think that EUR/USD could decline towards a level of 1.15. When the net-long euro positions are reduced, that will set the scene for a renewed rally in EUR/USD, again towards 1.20 level by the end of this year. Next year, we expect a continuation of euro strength versus the US dollar. We think that reduction in the pace of ECB asset purchases will be a more powerful driver of the currency pair than the reduction of the Fed's balance sheet. Our year-end 2018 target of EUR/USD is 1.30 (Georgette Boele)

Euro Macro: Eastern European euro countries already meet the ECB's inflation target - Core inflation in the eurozone persistently has been too low in comparison to the ECB's target during the last few years. Still, the aggregate of the small Eastern European countries Estonia, Latvia, Lithuania, Slovenia and Slovakia has already risen from just above 1% at the start of this year to 1.9% in August, thus meeting the target. This rise in core inflation was due to a sharp acceleration in wage growth. Indeed, wage growth in the five small EE countries has not only been almost three times as high as the eurozone total during the past few years on average, but it has also accelerated significantly since the middle of last year. Hourly wage growth was around 8.5% yoy in Q2, according to ECB data. This acceleration in wage growth is due to two factors. To begin with, the labour markets of these small EE euro countries have tightened and the unemployment rate has fallen well below the NAIRU on average. Secondly, wage growth is also fuelled by the fact that these countries have some catching up to do. The average yearly wage per person is about 25% of the eurozone average. In the convergence process towards the eurozone mean, wages in small EE countries tend to grow faster than the

eurozone average. For more on this, please read our Short Insight publication here.
(Nora Neuteboom, Aline Schuiling)

Links:

<https://insights.abnamro.nl/en/2017/09/short-insight-the-euros-eastern-tigers/>

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