ABN·AMRO

Daily Insight

Group Economics
Financial Markets Research

16 November 2017

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Euro strength has further to run in near term

Global FX: Continued euro momentum… for now - This week the euro has been the strongest G10 currency. There are several reasons for this. First, investors still strongly believe in a stronger euro. This is reflected in the further increase in net speculative long euro positions, even though they are already at historically-high levels. Moreover, as the euro found support below the 1.16 level, investors have bought on dips to see if the EUR/USD will rise again towards 1.19-1.20. Second, the positive impact of the US tax plan on the dollar seems to have faded as there is uncertainty when there will be a vote and when the effect on the economy will be felt. Third, a rate increase by the Fed in December is fully priced in. Therefore monetary policy expectations have not further supported the US dollar. Finally, the deterioration in investor sentiment that we experienced this week has weighed on the US dollar. This is not because the euro is a safe-haven currency, but because the US dollar is currently cyclically driven. We expect that EUR/USD will rise towards 1.19-1.20 in the coming weeks. If the rally runs out of steam before or around that level, it is likely that investors will take profit and close their long euro positions before the end of the year. This could result in a substantial weakening of EUR/USD in the last days and weeks of the year. (Georgette Boele)

ECB View: Hawkish comments from ECB's Mersch - ECB Executive Board member Yves Mersch struck a hawkish tone in comments this morning. He hinted at upward revisions to the ECB's growth and inflation forecasts in December and also warned financial markets against expecting a further QE extension after September 2018. Mr Mersch's comments are important as he is more to the center of the Governing Council and not an outright hawk. Indeed, he is likely one of the swing voters that President Draghi needs to get decisions through. Having said that, our view is that an extension after September 2018 has always looked unlikely in any case. In addition, a taper period (of at least 3-months but possibly 6 months) will follow and rate hikes do not look likely until the second half of 2019. So we do not think Mr Mersch's comments change the outlook for prolonged monetary stimulus in the eurozone. Indeed, our base case is that the ECB will not extend asset purchases further but will taper after September 2018 for six months. We have penciled in the first policy rate hike for September 2019. (Nick Kounis)

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