

FX Dots & Plots

8 June 2020

EUR: Near term supported, but not convinced structurally

- Even though it is middle of the G-10 pack in terms of performance over the past two weeks, the EUR has mostly set the tone for this round of USD weakness. With global risk sentiment showing no signs of easing, **the risk-reward probably still favours positioning against the broad USD, even though the failure to breach key technical resistance may open the way for some consolidation for the EUR in the coming sessions.**
- **Beyond the immediate term, we are sceptical of the EUR's continued rise.** The market seemed to have extrapolated on the Franco-German alliance on the virus recovery fund, and started to price into the EUR the potential of deeper fiscal union in Europe. For now, this leap may be too much of a stretch.
- **More importantly, relative central bank dynamics may turn against the EUR.** Thus far, the relative balance sheet expansion between the **Fed** and **ECB** had favoured the EUR. The Fed's rapid expansion of its balance sheet early the crisis has outweighed the ECB's own purchases. Despite the EUR600b expansion of the PEPP purchase limits, the actual balance sheet expansion at the ECB has not risen as quickly. Indicators tracking ECB purchases suggest only about one-third of the original limit has been utilized prior to the increase. **However, this dynamic may be shifting.** The Fed is already slowing down its weekly asset purchases operations. Meanwhile, the ECB seemed to have moved further towards the dovish end of the spectrum, with the ECB balance sheet expansion potentially picking up pace in line to the increase in limits. **Thus, we cannot rule out the possibility of the relative balance sheet expansion dynamics turning and weighing against the EUR going forward.**
- **Therefore, while the EUR may retain a supported posture in response to USD weakness, we remain unconvinced that the EUR's extension higher is sustainable on a structural horizon.**

Terence Wu

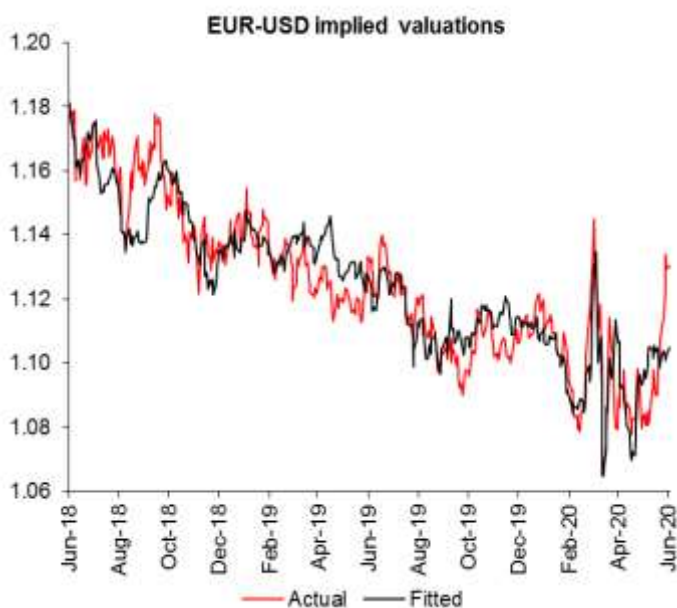
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