Global

Economics
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Rates

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FX Daily

Three reasons why we still forecast EUR/USD parity and beyond

EUR/USD experienced a short squeeze to start the year but we remain committed to our bearish forecasts and look for a move down to at least parity over 2016. Here are three reasons why.

ECB has more ammunition to ease

The BoJ experience points to the constraints of additional easing, and yesterday we introduced two dimensions along which these constraints can be assessed: fixed income risk premia and banking sector profitability. On both metrics there seems to be scope for additional easing in Europe. The European GDP-weighted yield curve is steep compared to others and European banks' share of fixed income assets is not as high as in Japan or the US. With a mix of weakening macro data, tightening financial conditions and stalling in the EUR downtrend, the ECB has all the required excuses to deliver an all-rounded easing package in March.

Reserve managers a big negative for the euro

The ongoing decline in FX reserves doesn't matter for the yen because central banks don't own Japanese assets. In contrast, the euro is the world's second major reserve currency and the drop in EM reserves requires ongoing EUR/USD selling to maintain constant relative FX allocations. Our best estimate of the drawdown in reserves over 2016 is 700bn-1.6trillion on an FX-adjusted basis (chart 1), which assuming a 25% euro share is equivalent to 200-400n of euro selling.

Europe is not Japan

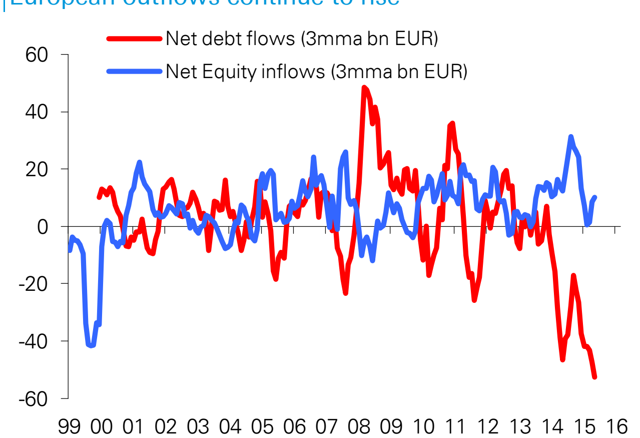
When risk-aversion hits the JPY strengthens because the Japanese repatriate foreign assets. Risk-off causes some euro short covering, but the key difference with Japan is that Europe's international investment position is still negative. This means there are still more foreigners invested in European assets that Europeans offshore, reducing the positive flow impact on the EUR. Europe's negative international investment position is a key component of our Euroglut hypothesis of persistent outflows, and the latest Eurozone data released last week show 500bn annualized outflows in the last quarter of last year, another record high.

Reserve managers losing trillions, have to sell euros

	H2 2015	Scenarios for 2016		
USD, bn		H215 pace (annualiz.)	China sells $50bn/month and 10% more selling from SWFs	China sells $100bn/month and 33% more selling from SWFs
Central banks, of which..	-290	-580	-400	-1,100
developed markets	140	280	300	300
China	-220	-440	-600	-1,200
other EM	-210	-360	-400	-450
SWFs	-90	-180	-200	-240
Global reserve loss	**-400**	**-700**	**-900**	**-1,600**

Source: Deutsche Bank, Bloomberg Finance LP

European outflows continue to rise



Source: Deutsche Bank, Bloomberg Finance LP

*http://pull.db-gmresearch.com/p/12980-9D3B/63735986/DB_SpecialReport_2016-02-22_0900b8c08ad0fc8d.pdf

Appendix 1

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