FX majors

EUR (euro): the plot thickens

- **We revise our EURUSD forecasts lower for this year because of several recent developments (explained below)...**
- **...while still maintaining a modestly constructive view based on the ongoing sharp recovery in global trade and growth**
- **However, risks to the downside appear to be intensifying.**

At the core of our constructive EUR view has been the swift recovery in global trade and growth, which empirically has been associated with EURUSD appreciation and, in particular, overshooting its fair value (see chart 4) which we currently estimate it to be around 1.20. In principle, this is driven by **1.** USD selling, as investors flee safe haven assets and **2.** The eurozone's high exposure to global trade.

However, recent developments have generated a number of EUR headwinds that are likely to restrain EURUSD appreciation. **First**, the increase in US nominal and real yields has been quite rapid, underpinning the dollar and weighing on funding currencies like the EUR. This is even more important when taking into account the European Central Bank's dovish stance in its recent meeting: The Bank announced that it will increase appreciably its bond purchases under the PEPP (Pandemic Emergency Purchase Programme) in Q2 2021, potentially hinting into some sort of yield-targeting.

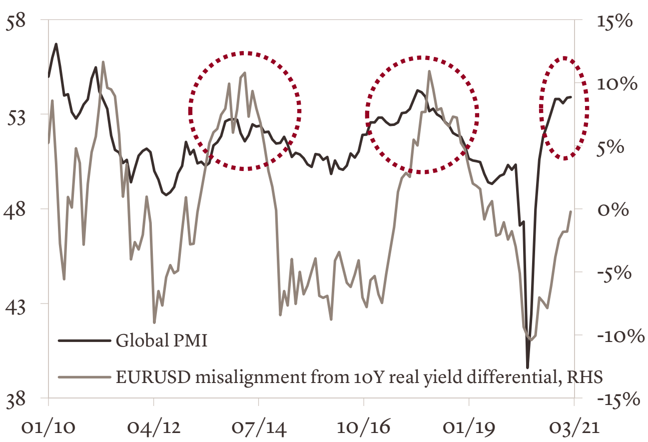
Second, the pace of vaccination roll out remains slow in Europe (see chart 5) while other bottlenecks are only compounding the problem. Finally, the rise in confirmed Covid-19 cases in many European countries is increasing the risk of renewed lockdowns and thereby the risk of a more prolonged impact on economic activity. **Third**, the results from the German regional elections show that the Christian Democratic Union has sustained a heavy defeat, which increases the risk that its coalition may not hold onto the Chancellorship in the September 2021 general elections.

All that said, we believe that the rise in US yields so far reflects growth optimism and that they will avoid a further overshoot that could concern investors over their impact on growth. If we are right in our assessment and the vaccination rollout in Europe manages to reach a respectable pace then we would expect EURUSD to be supported due to the global trade recovery and converge closer to our new target of 1.23 by the end of Q2 2021 or early Q3 2021.

Risks to our views:

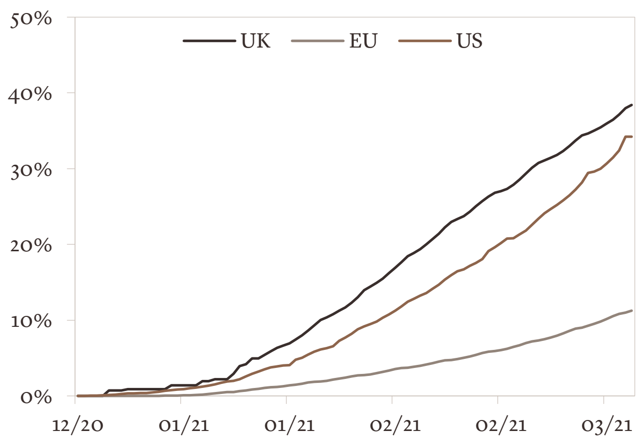
Downside risks: Overshooting US yields (potentially also driven by the new US fiscal stimulus of USD 1.9tn); the slow rollout of vaccinations in Europe; the Fed not pushing back on the pricing of rate hike expectations, which by the third week of March had reached nearly three 25bps increases by December 2023. **Upside risks:** An even stronger economic and trade recovery as well as a more efficient roll out of the Covid-19 vaccines.

4. EURUSD overshoots fair value during global growth upswings



Sources: Bloomberg, Lombard Odier

5. Covid-19 vaccination (first dosage) as a share of population



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.