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Euro Q3 Forecast 2014

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Has the ECB Done Enough to Keep the Euro Falling?

By Christopher Vecchio, Currency Analyst and Jamie Saettele, Senior Technical Strategist

After weeks and months of endless speculation, the European Central Bank made good on its promise for substantive policy action at its June meeting. However, in light of the Euro's resiliency in the wake of the new, non-standard policy measures, the question must be asked: did the ECB do enough to keep the Euro trending lower?

Evidently, the market is taking the ECB's actions as a sign that they're willing to do what is necessary to help spur lending and ultimately growth in the region; but not necessarily weaken the Euro. To this point, the Euro has stayed elevated as EONIA rates have plunged. The overnight interbank lending rate slumped to 0.01% in mid-June, in line with the ECB's efforts to narrow the interest rate corridor by dropping the lower bound into negative territory. Liquidity is seen as plentiful and risk is seen as a distant likelihood, continually driving real money into the Euro-Zone (which has been an ongoing process over the past several months and years). QE, the greatest possible threat to the Euro, is seen as an extremely unlikely next step taken during Q3 as the ECB presses forward with its asset quality review, the Euro-Zone stress tests due at the end of October.

With European bond yields falling (prices rising), equities prices rising, and the Euro staying elevated in the wake of the ECB meeting, we can at least surmise that investors aren't abandoning the region wholesale even as a negative interest rate regime sweeps across the region. Market participants are more interested in the developing price environment, as that will ultimately be the determinant of what the ECB does next. Speculation around the Federal Reserve rather than the ECB will be the more important driver for EURUSD in Q3'14.

EURUSD May be Ready to Move Out of 2014 Range

EURUSD Weekly Chart - Created Using FXCM Marketscope 2.0

The EURUSD 2014 range has been confined to 1.3476-1.3993. The weeks that have made the high and low comprise 80% of that range! In other words, the trades have been at the turns with little left in between. There are indications that the May high was important though.

First, the break below 1.3672 was the first break of a pivot low with left and right strength of 4 (4 weeks on either side of the low) since the rally began in 2012. Also, the week of the top (week ended 5/9) shares specific characteristics with other important tops. Those characteristics are a 52 week high, key reversal (weekly), and RSI below 60. This has only happened 5 times since the euro was introduced; the weeks that ended 2/20/2004, 6/9/2006, 7/18/2008 (all-time high), and 5/6/2011. In 2004, the EURUSD closed the reversal week at 1.2513 and made its low 2 months later at 1.1757. The 2008 and 2011 highs are still in place. Only the 2006 reversal failed to identify a meaningful top. Once that high was broken, EURUSD went on a tear. With that in mind, I'm inclined to adopt a bearish stance as long as the May high is in place.

Resistance clusters between 1.3750 and 1.3840. A double top would trigger on a break below 1.3476 and the pattern would yield an objective of 1.2968. This level is in line with the 50% retracement of the advance from the 2012 low at 1.3017 so consider the area around 1.3000 a general target.

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