Everyone hates the euro

am FX

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16BR, $463 million

Current Views

Long EURUSD @ 1.0488
Stop loss 1.0374
Take profit 1.0720

When I put out the bullish EURUSD view last week, the reaction was negative. The market is clearly bullish USD and bearish EUR. The aggressive sentiment reaction should be a red flag for EUR bears as this kind of feedback tends to show a market leaning hard one way.

Another sentiment marker is the absolute derision and snark heaped on the ECB's decision to create an antifragmentation tool. My initial reaction was the same, and for good reason, but this is universal derision is also a red flag for euro bears. At other times in history, an emergency meeting by a central bank to verbally intervene in a market (BTPs) ahead of a policy announcement would be enough for a 1% rip higher in the currency. Instead, EUR went up 65 pips then down 100 after the emergency ECB meeting. Central bank credibility is at a low ebb. I understand why!

Still, low central bank credibility and heavy USD bullish sentiment create an asymmetry going into the July ECB meeting. If they can somehow figure out a program that credibly backstops Italy without increasing the balance sheet, then embark on a series of rate hikes, EURUSD will rip. Even if they don't, I think it's an important tell that despite all the snark, BTPs are tightening and rate differentials are moving in favor of the EUR, not against it.

The ECB has a problem as they are trying to do something nearly impossible:

- Fight inflation
- Support the currency
- Buy BTPs (if necessary)
- Hike rates

Reinvestment isn't enough. The amounts are too small. Here's Schnabel last week:

> While the flexible allocation of PEPP reinvestments is one way to address fragmentation, our commitment is stronger than any specific instrument. Our commitment to the euro is our anti-fragmentation tool. This commitment has no limits. And our track record of stepping in when needed backs up this commitment.
>
> How we ultimately react to risks of fragmentation will firmly depend on the situation we are facing. We have shown in the past that we can adapt flexibly and quickly to the specific circumstances.
>
> While the OMT required strict conditionality to address the underlying vulnerabilities, moral hazard was much less of a concern when the pandemic hit. Therefore, the PEPP was, by design, unconditional, but also temporary and linked to the pandemic.
>
> We will react to new emergencies with existing and potentially new tools. These tools might again look different, with different conditions, duration and safeguards to remain firmly within our mandate. But there can be no doubt that, if and when needed, we can and will design and deploy new instruments to secure monetary policy transmission and hence our primary mandate of price stability.

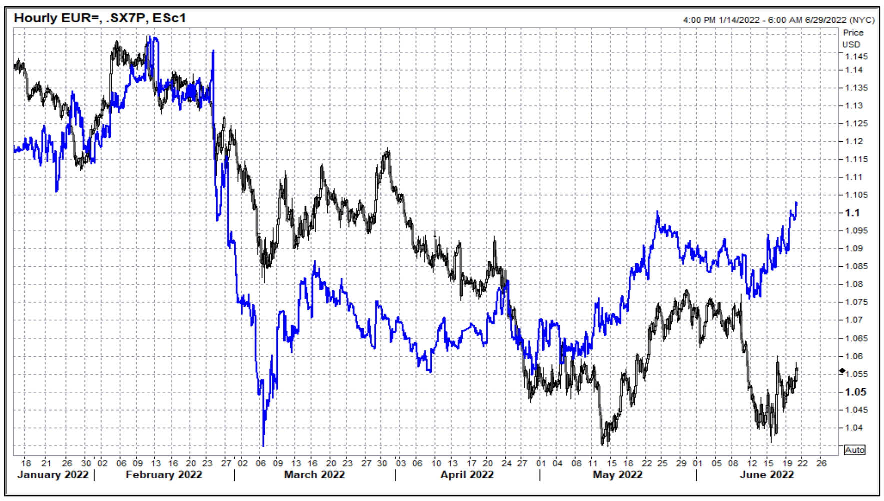
I don't want to overstate the odds that the ECB can thread the needle and present a credible antifragmentation tool. I am simply highlighting that nobody believes they can do it and thus nothing is priced in. Lagarde is a lawyer—this is right in her wheelhouse. By the way, that Schnabel speech was a commencement speech. Talk about boring. Must have been one of the most boring and least-inspirational commencement speeches of all time.

Dollar

Forgetting about the ECB antifragmentation tool for a second, let's look at four themes drove the USD higher over the past year and where we currently stand on each one.

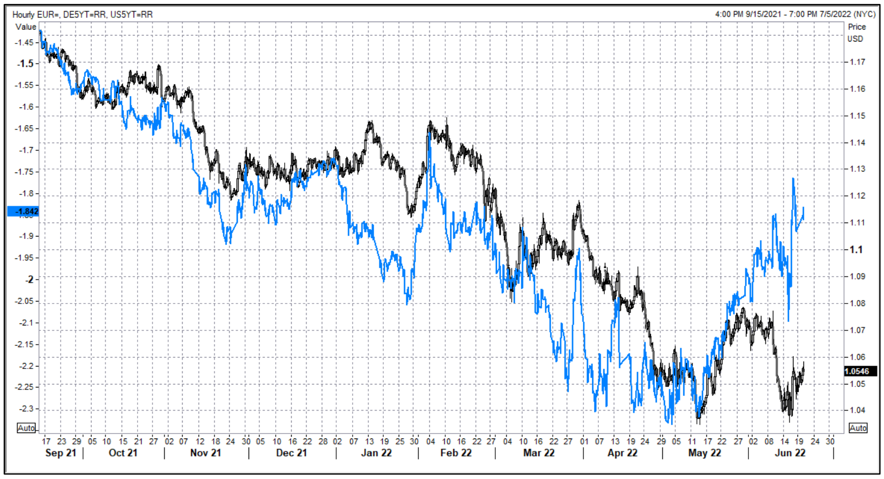
1. **Equity exceptionalism.** This was the big one and the original source of USD strength as money flowed into US megatech throughout 2021 because "There Is No Alternative". Here's 2022 equity performance, Europe vs. USA. Europe on the comeback trail.

EURUSD vs. Europe equities / S&P 500 ratio (hourly in 2022)



2. **Central bank divergence**. The Fed was more hawkish than the rest of the world and this was reflected in aggressively wider rate differentials. US rates are higher beta, so they tend to go up faster than the rest of the world, plus the Fed was more committed to normalization than many other CBs. Now, that theme is growing tired as the BOJ is really the only CB still frozen in place. Rates in Europe are moving up faster than the US. Same with rates in the UK. And Oz. And NZ.

EURUSD vs. Germany/USA rate differential (hourly back to September 2021)



3. **Equity collapse = safe haven USD bid**. Whether the news was good or bad, the USD seemed to benefit as we hyperspaced back and forth from one side of the dollar smile to the other without ever visiting the middle. My view is that the cooling off in oil, lumber, trucking, housing, goods, and many other parts of the economy puts us in a less scary position for equities. The weekend blowoff bottom in crypto might help too (though I'm nervous about liquidations into half-year end). So, my call is that it's time for a relief rally in stonks.

   A few more small reasons I think stocks stabilize:

   - Oil, housing, and commodities have taken the scary edge off the forward-looking inflation story (for now, at least!).
   - FedEx ripping (often a lead indicator).
   - USDCAD massive double top (it has been a risk proxy for ages).
   - VIX fails at 35 again for the umpteenth time.
   - OPEX just passed without a hitch (bullish).
   - The overall vibe is quiet today (don't be short a dull market).
   - Blowoff bottom in crypto. Crypto contagion risks peak into half-year end, then dissipate. See MacroTactical Crypto #22 and #23 (out later today) for more on this theme.

4. **Fragmentation**. Very recently, the EUR has been pressured vs. the USD by the big moves in Italian and Greek yields. This is a natural outcome as the ECB raises rates and peripheral yields are more volatile than core yields. But recently, spreads have come back in despite the market's deep distrust of the ECB's verbal antifragmentation reassurances. **Greece and Italy are ripping tighter.**

   EURUSD vs. Italy and Greek spreads (hourly back to September 2021)

I like this long EURUSD setup.

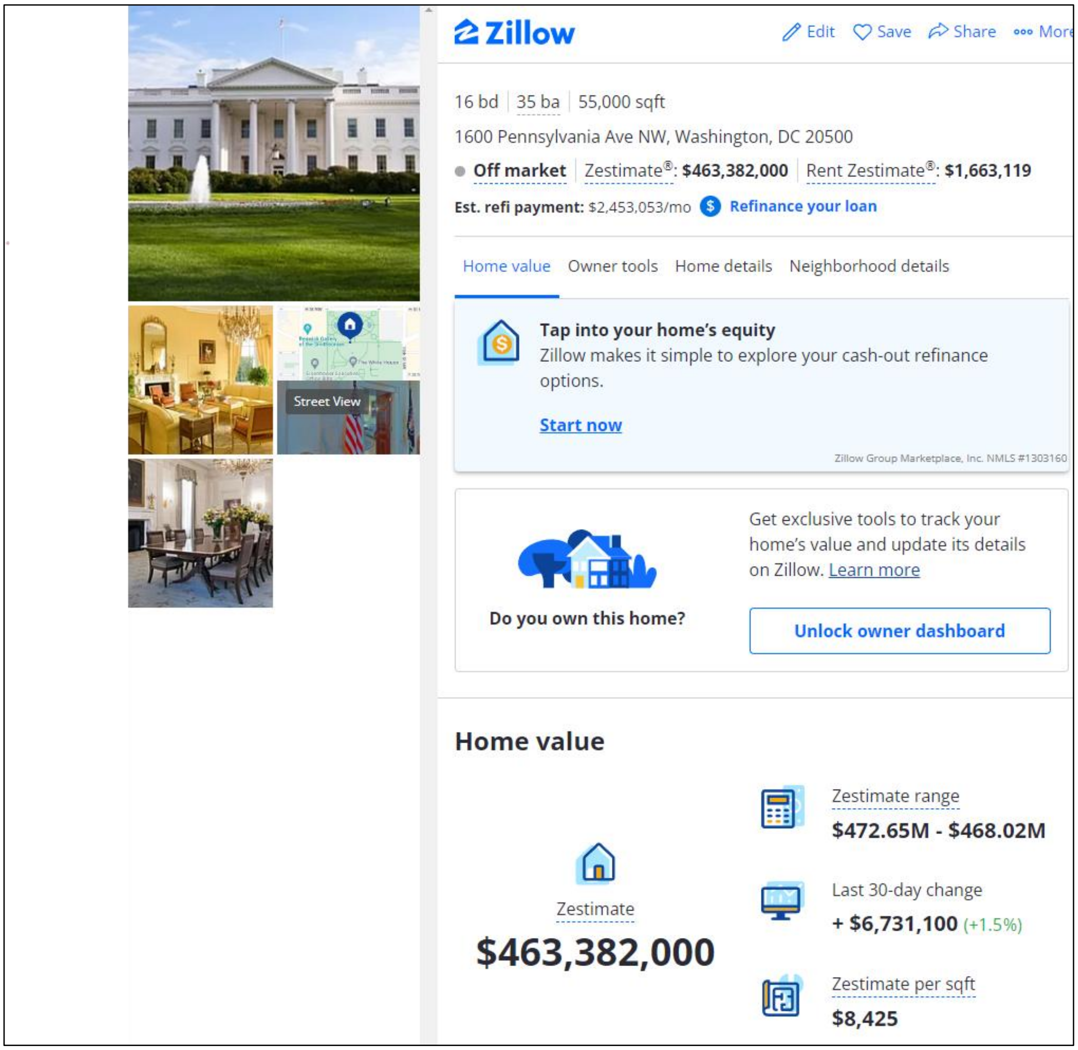
People hate it, the story is turning at the margin, and the surprise asymmetry is the right way. And the entry point is good. And if oil stops going up, the energy crisis in Europe gets less bad.

1.0700/20 target. Let's see what happens.

Final thought

I could stare at this video all day. Nature is lit.

good luck ⇅ be nimble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Off market | Zestimate®: $463,382,000 | Rent Zestimate®: $1,663,119
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Home value
Zestimate
$463,382,000
Zestimate range
$472.65M - $468.02M
Last 30-day change
+ $6,731,100 (+1.5%)
Zestimate per sqft
$8,425

OK, sure.

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