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Euro-Dollar is moving towards parity: Anand Rathi Commodities

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The euro has come under severe pressure as the economic and political situation in the euro zone are exacerbated. Several countries of the euro zone (Italy, Greece, Portugal, Spain) are in shambles. The debt-to-GDP ratios of these countries are significantly higher. Their banks have a huge chunk of non-performing assets, posing a threat to financial stability. This was more evident when rumours spread about possible collapse of Deutsche Bank. Government bond yields in several euro-zone countries are in negative territory. Over a period of years, the European Central Bank has adopted unconventional monetary-easing measures. It is one of the major central banks to adopt negative interest rates. It also started a humongous quantitative-easing programme. But the programme has achieved little.

Inflation is still running well below the ECB's target of 2%. Other economic indicators have been restrained. Adding to this, a wave of rising populism globally including in the euro zone is worrisome. It started with BRexit followed by Donald Trump's presidential election victory in the US. Earlier this month, Italy rejected a referendum regarding constitutional amendments. The Five Star movement, an anti-establishment party, is gaining popularity in Italy. Germany, France and the Netherlands are scheduled to hold general elections in 2017. Anti-immigration and populist parties are gaining popularity in these three nations. If elected, questions would arise regarding survival of the euro zone.

ECB policymakers are already frightened about the impact of BRexit on the euro zone. A possible win by anti-establishment parties in Germany, France and the Netherlands could be a fresh headache for the ECB. Earlier this month, the ECB extended its ongoing QE programme till December 2017, from the earlier March 2017. Of course, the ECB would extend the program from April at a slower pace of €60 billion ($65 billion) a month, from €80 billion now. But it warned that if the outlook turns less favorable or if financial conditions become inconsistent with further progress toward a sustained adjustment of the path of inflation, the Governing Council intends to increase the program in terms of size and/or duration.

Besides, uncertainty over US president-elect Trump's policies has rattled the sleep of ECB policymakers. If Trump implements his election-campaign promises regarding economic and foreign policies, it would have a huge negative impact on the global economy. The euro zone economy is no exception. Trump plans US withdrawal from TPP and NAFTA. He also plans to reform policies, with an America-First trade policy, and label China a currency manipulator. Trump's possible inward-oriented economic policies could trigger a trade war in the global economy. This could hurt euro-zone exports.

The buzz in the market is also that the incoming Trump administration would provide a fiscal stimulus to boost the US economy. Big government spending would fuel inflation in coming months. As a result, the Fed may need to raise interest rates to head off inflation. The latest dot chart shows that Fed officials see inflation hitting to 1.9% in 2017 and 2% in 2018. As a result, the Fed raised the interest rate by 25bps at its 13th-14th December monetary-policy meeting. New projections show central bankers expect three quarter-point rate increases in 2017, based on median estimates, up from two seen in the previous forecasts in September. All these factors point toward the fact that euro-zone challenges are expected to mount considerably in future. This could push the euro-dollar towards parity soon. Hence, concrete, bold and careful steps are needed from the ECB to support the euro-zone economy.