Flash Economics

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The outlook for the dollar-euro exchange rate

There is every reason to expect the euro to depreciate significantly against the dollar:

- The prospect of higher inflation and higher short-term interest rates in the United States, but not in the euro zone;
- Higher corporate profitability and higher long-term interest rates in the US, attracting capital from the euro zone to the US;
- Political uncertainty (in Germany and France);
- Very weak growth in the euro zone.

A depreciation of the euro against the dollar:

- Is good for the competitiveness of European industry; however, the depreciation will not compensate for the tariffs that will hit European products imported into the United States;
- Is bad because it raises the price of energy and raw materials imported by the euro zone.

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There is every reason to expect the euro to depreciate against the dollar

1. **'The economic policy advocated' by Donald Trump (lower taxes, much higher tariffs, curbs on immigration) will lead to significant additional inflation in the United States.**

The result will be **a rise in short-term interest rates in the United States**, which is already very visible, **whereas short-term interest rates in the euro zone have risen only slightly since December 2024** (**Charts 1A/1B/2**).

Chart 1A
Interest rate on 2-year government bonds (as %)

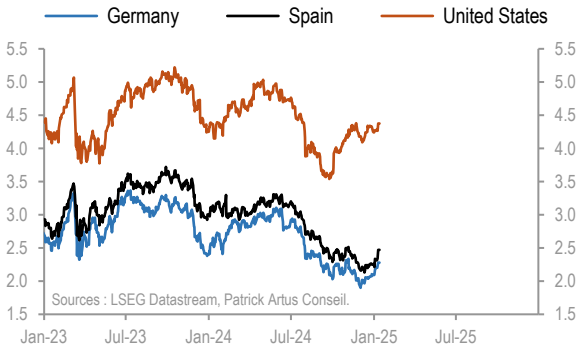


Chart 1B
Interest rate on 2-year government bonds (as %)

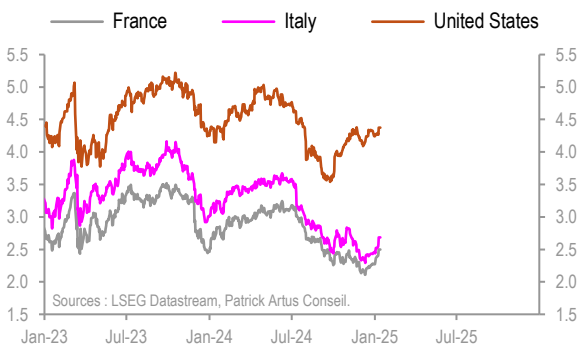
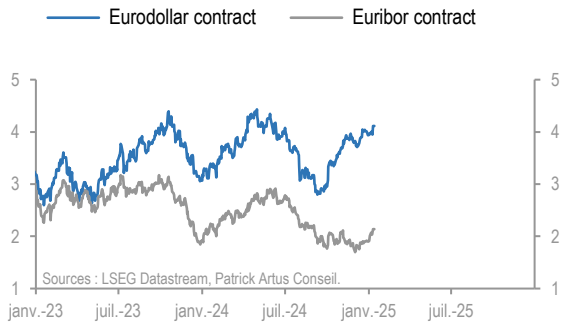


Chart 2
Eurodollar and Euribor contracts (3-month)
(December 2025 maturity)



This widening of the gap between short-term interest rates in the United States and the euro zone clearly favours an appreciation of the dollar against the euro.

2. **Long-term capital is being attracted to the United States, and not to the euro zone (Chart 3**, in this chart, a negative value indicates a capital inflow**) because of:**

- **Long-term interest rates in the United States being higher than in the euro zone** (**Chart 4**).

Chart 3
Net direct and portfolio investments*
(as % of nominal GDP)

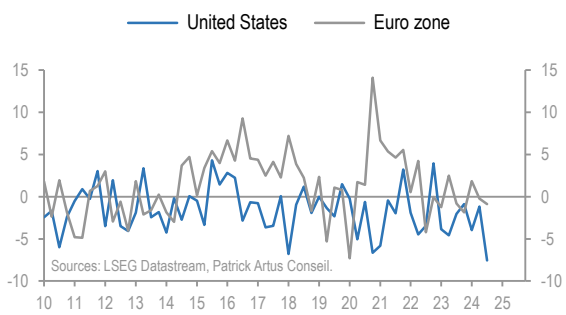
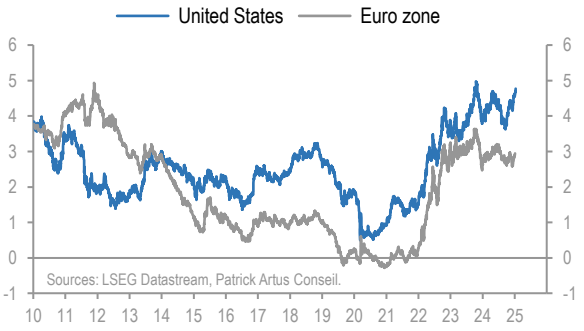


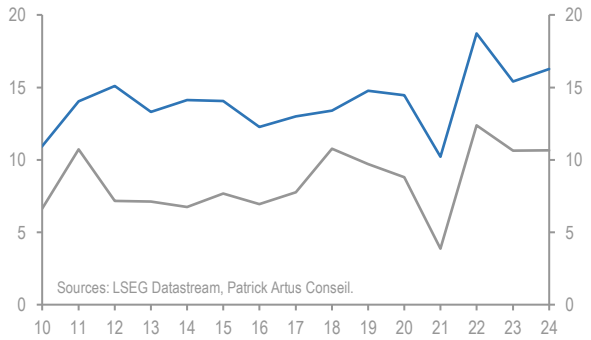
Chart 4
Interest rate on 10-year government bonds (as %)



(*) The direct and portfolio investment balance represents the change in the net international investment position. An increase in the net international investment position has a positive sign

- **The return on corporate capital** being higher in the United States than in the euro zone (**Chart 5**).

Chart 5
RoE



3. Political uncertainty in Germany and France

Early elections will be held in Germany on 23 February while the French government is fragile, lacking a majority in parliament and therefore liable to being overthrown. This political risk in the European Union's two largest countries may discourage investors and contribute to the euro's depreciation against the dollar.

4. Very weak growth in the euro zone

Growth in the euro zone is significantly weaker than in the United States (**Chart 6**), and the **latest economic indicators point** to a recession in the euro zone (**Chart 7**).

Chart 6
Real GDP (Y/Y as %)

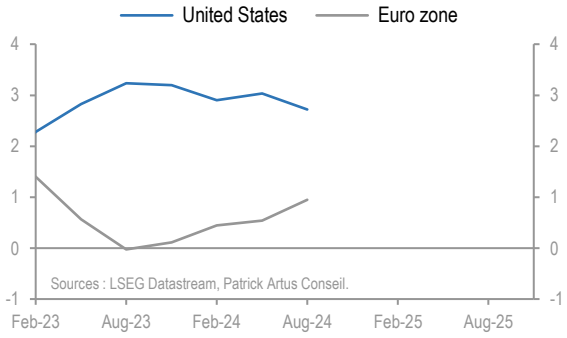
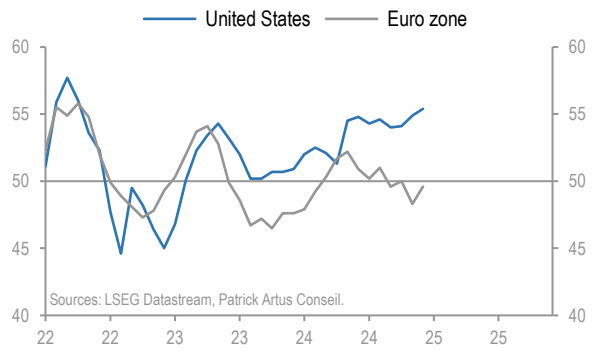


Chart 7
Composite PMI indices



Weak growth in the euro zone is discouraging investors and contributing to the weakening of the euro against the dollar.
All in all, these mechanisms should lead us to anticipate a depreciation of the euro against the dollar, which has already begun (**Chart 8**).

Chart 8
Euro/dollar exchange rate (EUR 1 = USD...)



Summary: the effects of a depreciation of the euro against the dollar

A depreciation of the euro against the dollar is very likely given the differences between monetary policies, the greater attractiveness of the United States for capital, political uncertainty in Europe and weak growth in the euro zone.

A depreciation of the euro against the dollar is good for the competitiveness of the euro zone, particularly for companies that have selling prices in dollars and production costs in euros.
However, this advantage in terms of competitiveness risks being cancelled out if the United States imposes **tariffs** on products imported from Europe.

Conversely, a depreciation of the euro against the dollar pushes up the price of energy (and other raw materials) in the euro zone, since the price of oil and natural gas is set in dollars.

Statistical analysis shows that the price elasticity of euro zone exports and imports in volume terms is low (0.4 for exports, practically 0 for imports): a depreciation of the euro is therefore unfavourable in terms of income for the euro zone.

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