When Mark Beat Mario:

why the EUR/GBP pair looks like a 2014 bear.

By Francesco Sani, 26th December 2013.

In this article, I will discuss why the EUR/GBP can offer traders a good selling opportunity as we move into the beginning of the new year (2014), on the basis of technical and fundamental factors.

In the monthly EUR/GBP chart screenshot above, we can see how the European Union performed against the UK since the early 1990s, in the days before the EMU: what is noticeable is that the launch of the single currency was heralded by fear in the European markets, with German unenmployment in 1996 being at its highest since 1933 and with the announcement in 1997 that debt-laden countries such as Italy were to become part of the EMU. Why is this relevant?

Seventeen years from that 2,500-pip drop (boxed in red and yellow on the chart), this currency pair has returned to the same levels: the 600-pip range of 1995-1996 (boxed in black and pink on the chart) has now held for the whole of 2013. What is poignant is that the 1997 collapse below this range could be replicated, albeit at a less dramatic pace: the current descending channel, spanning a consistent range in excess of 1,200 pips, and which began to take shape in the aftermath of the 2008 global financial crisis, has been tested at its ceiling (solid green line on the chart) in July of this year, which coincided with the upper band of the aforementioned historical 600-pip range (dashed green line on the chart) around the 0,88 level.

The floor of this channel (solid red line on the chart) was last tested in July 2012 (circled in red): if we took the June 2010 as the first test of this channel floor, then we could project the next channel floor test in [(18+25)/2 =] 21.5 months, making April-May 2014 our next target; alternatively, if we took June 2010 as the start of the channel floor, then July of this year would have been the first test, and we would not have a means to deduce an average period as a cycle. In the latter case, we could look at the twelve-month period of July 2011 to July 2012, which is the period between the last ceiling-to-floor price movement within the channel, as the expected possible period before the next channel floor test, putting it at July 2014: both scenarios give us a floor around the 0.75(xx) figure, which is an important one as it coincides with the 0.76 Fibonacci retracement of the massive move from the Sep.2007 low to Dec.2008 high.

Another cyclic aspect for this pair finds its fulcrum in the 0.77(xx) figure: this represents the mid-way, mathematical half between the lowest level (in 2000) and the highest one (in 2008) of the EUR/GBP pair for the last two decades: the July 2012 test of this level (coinciding with our descending channel floor) represents the exact half-way point of a retracement of this eight-year, c.4,100-pip rise, and even though we have no way of trading it with absolute certainty, the idea of a 100% retracement to a 0.56-0.57 figure by 2016 could be one to keep in mind for anyone looking into building a long-term strategy.

While price action on the EUR/GBP daily chart remains below the 200-day

MVA (simple moving average), as it has done since September of this year, and the Slow Stochastics oscillator crosses its moving average to the downside on a monthly time frame, I remain confident that the probability of this pair breaking back above it in the foreseeable future is indeed low: as I will explain in the following paragraph, we are currently lacking a truly positive fundamental theme (beyond the already digested ECB rate cut or a possibile future ECB negative rate, for example) that could make us reconsider our bias.

Which fundamentals, then, add weight to a technical analysis leaning toward a bearish EUR/GBP bias? Let us look at eight fundamental aspects, comparing EA-17 (=EuroZone) and UK data in the closing months of 2013:

EuroZone	United Kingdom
Inflation: 0.7% (Oct.2013)	**Inflation: 2.2% (Oct.2013)**
Interest Rate: 0.25% (Dec. 2013)	**Interest Rate: 0.5% (Dec.2013)**
Government Debt: 93.4% of GDP (2Q2013)	**Government Debt: 88.3% of GDP (up to Apr.'13)**
Exports Revenue: Sep. 2013 extra-EU28 trade balance: €+0.6 bn.	**Exports Revenue: Sep. 2013 extra-EU trade balance: £+11.9bn.**
CPI Index (HICP):Oct.2013: 0.73%	**CPI Index: Oct.2013: 2.2%.**
Growth (GDP change, Q/Q & Y/Y): Q3 (Jul-Sep.2013): +0.2% ; Y/Y(yearly change): +0.1%.	**Growth (GDP change, Q/Q & Y/Y): Q3 (Jul-Sep.2013): +0.8%; Y/Y(yearly change): +1.5%.**
Growth (PMI change, m/m): EA-17: 51.9, Oct.2013.	**Growth (PMI change, m/m): 56.0, Oct.2013.**
Unemployment: 12.2% (Sep.2013)	**Unemployment: 7.7% (Sep.2013)**

What can we deduce from this? Besides speculation that Draghi will do 'whatever it takes' to keep the European single currency project afloat, and that a version of the British Funding for Lending Scheme (to revive bank credit for small businesses) may be a possibility, what else is there? Of the above fundamental data, five from the European side stand out particularly:

1) a lower inflation;

2) a lower interest rate;
3) a higher government debt;
4) a weaker GDP growth;
5) a higher unemployment.

Merging the fundamentals and the technicals, I see a 2014 that has very difficult challenges for this pair to stem its slide to lower lows; where the EUR/AUD and EUR/JPY, for example, have embraced bullishness with astonishing vigour, the EUR/GBP is paired neither with the fundamentally weak RBA nor with the massive BoJ stimulus programme, but with a British economy that has outperformed the EA-17 in terms of real, proven growth.

Going forward into 2014, then, we can confidently set our sights on the 0.82 mark, which is the 50% Fibonacci retracement level of the Sep.2007 low to Dec.2008 high: with price currently around the 0.8350 mark, we are nearing said Fibonacci level at every step: a break through it would see confirmation of this pair driving through not only this level but also the 1996-1997 range floor, which would then give us the 0.61 and the 0.76 Fibonacci retracement levels (at 0.7908 and 0.7460 respectively).

Combining the aforementioned technicals of a multi-year descending channel with the additional bonus of carry/rollover offered (a 0.25 interest rate differential between the two currencies) makes any EUR/GBP selling an appealing opportunity in 2014, and one that I will be watching.