



Our hypothesis that euro weakness has been driven by an ongoing shift in portfolio managers' preferences is also demonstrated by our new CORAX data, which show continual EUR/USD selling by real money investors over the last twelve months. The leveraged community, by contrast, pared euro shorts after Q1, perhaps because many investors underestimated the persistence or relevance of real money outflows (figures 9 & 10). To be sure, recent euro weakness has mainly come from speculators re-pricing ECB policy. Nonetheless, the fundamental pressure on the common currency this year has come from real money investors, just as the yen's persistent weakness in the second half of the year has largely stemmed from real money outflows.

We conclude that it is not just the ECB that has driven euro weakness, but the resulting shift in European portfolio flows and the sharp deterioration in the Eurozone basic balance.



Where are the outflows going?

Relative to existing net assets abroad, a disproportionately large share of European fixed income outflows has gone to the US. In Q3 2015 only a third of foreign bonds held by euro area residents were American, but 45% of bond purchases since then have been in the US (figure 11). This may be because European investors have a disproportionate preference for AAA fixed income securities. Yet considering that investment in Swiss fixed income has all but ceased, it seems that yield remains the main incentive, as we originally argued. European demand may indeed be one reason for surprisingly low yields in the US.

As mentioned above, a more recent development is that foreign investors have increasingly divested European fixed income. One notable change is that Americans have started to be net sellers of foreign bonds to Europeans, inclusive of the UK. Although some of the transactions in the TIC data may be in non-European bonds, it is safe to conclude that US investors have been reducing fixed income investments in the euro area (figure 12).