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ECB Cheat Sheet: Start and stop

We look at different scenarios ahead of this Thursday's ECB announcement. With expectations firmly centred on a 25bp rate cut, most of the focus will be on comments on inflation and future easing. A "hawkish cut" may provide some support to the eurozone yields, but the next big move in EUR/USD should still be caused by US macro developments

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rates	Other monetary tools		
Current stance	Inflation is expected to decline gradually	Economic activity weak in coming months, but should pick up over time	Depo at 4.00%. Data-dependent approach to future decisions	PEPP reinvestments slow in 2H before stopping end 2024	**EUR/USD (1.086)**	**10Y Bund (2.55%)**
Dovish	Risk of undershooting target in 2025 and beyond	Risks tilted to the downside, evidence of rebound activity still scarce	**25bp cut.** Rates may be lowered at consecutive meetings (July)	ECB has all tools at its disposal	1.073	2.45%
Moderately dovish	Playing down latest data, confidence on target to be met in 2025	Risks tilted to the downside, although some improvement in leading indicators	**25bp cut**. Forward guidance for at least one more cut this year	Portfolio run-off is independent of rates decisions	1.080	2.50%
Moderately hawkish ING base-case	Latest data suggest lingering risks to prices, disinflation to be only gradual	Signs that growth outlook has started to improve, risks more balanced	**25bp cut.** Any further easing will only be gradual. No guidance	Portfolio run-off is independent of rates decisions	1.090	2.60%
Hawkish	Lingering upside risks like wage pressure warrant *caution* on infl.	Balance of risks for growth is moving to the upside	**No cut.** A rate cut later this year depends on incoming inflation	Balance sheet normalization could still be sped up if needed	1.100	2.75%

Source: ING

This note is part of our ECB June previews. Our economics team preview can be found here

Rates: Room for repricing higher, but US remains key

In rates markets, a cut by the European Central Bank on Thursday is already fully baked into the curve, with forward pricing nearly 25bp. But it's the outlook beyond June that is still open, despite communication from officials having started to move out the curve. A back-to-back cut in July is deemed unlikely, with markets attaching only a roughly 10% chance to that scenario. A second cut is almost fully priced by October, but it's a third cut this year that is hanging in the balance.

However, the pricing further out the curve is also influenced by drivers from abroad. Weaker US data as well as sliding oil prices have also helped push rates lower in the eurozone. While EUR markets have been leaning towards a three-cut scenario for this year again, the domestic data on negotiated wages and the latest CPI print over the past weeks would argue for a more hawkish line at the upcoming meeting.

Therefore, there is room for markets to reprice higher – but in the end, we believe that they will still oscillate around the two or three-cuts scenario for now unless we get more evidence from the data. This will also spill out into the longer end of the curve, but here the factors from abroad should be felt even more with the US jobs data looming large. This will then determine whether we can get above 2.6% more lastingly in the 10Y Bund yield on a hawkish ECB.

More questions than answers for FX

The ECB's forward guidance experience (i.e., signalling a June rate cut) may be short-lived. As outlined in our baseline scenario, we expect the ECB to scale back its guidance endeavour and swing back towards data dependency after stronger-than-expected wages and inflation figures.

EUR/USD has been trapped in a relatively tight range, and still relies more on cues from US macro than eurozone developments for the next big move. If some lack of guidance by the ECB can be read as a hawkish signal and give some support to the euro short term, the fact that the ECB has moved before the Federal Reserve – and despite higher inflation and wages – should make markets quite comfortable with jumping back into pricing in two more cuts in 2024 (after the June move).

Markets have been more reticent to price in easing in the US of late – but if we are right with our call for a first Fed cut in September, then the dollar should have a bad summer. While the euro (along with CAD and GBP) may lag other pro-cyclical G10 currencies in a USD decline, EUR/USD should still be able to make it to 1.10 in the coming months.

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