ECB and EUR crib sheet

The euro should largely look through this week's European Central Bank meeting, with EUR/USD risks remaining skewed to the downside. The attractive funding characteristics of the euro should be kept in place by the ECB for a while yet

	Inflation outlook	Growth outlook	Interest rate & QE decision	Strategic Review	EUR/USD
Current stance	"Over the medium term inflation is expected to increase"	"The risks... to growth outlook... remain tilted to the downside"	Deposit rate at 0.50%, easing bias on rates and EUR 20bn QE pm	All encompassing start of the Review, aiming end 2020 completion	
Dovish	Inflation pick up too slow to bring CPI to the target	Recent data don't suggest a sustained easing of risks	Downside risks still present, further cut still on card	Review deadline may extend beyond 2020	1.090
ING Base Case	Recent data suggest that underlying inflation will pick up	Recent data suggest **bottoming out in manufacturing**	No change, inflation conditional guidance remains	Deadline date (end 2020) reaffirmed. Broad review focus.	1.110
Hawkish	Confident that underlying inflation will move towards target	Downside risks have started to disappear	Econ. conditions reduce the need for current easing bias	Earlier than end-2020 review completion	1.12
Very hawkish	Risks to the inflation outlook are balanced	Risks to the economic outlook are balanced	Dropping the easing bias in forward guidance on rates	Earlier review completion	1.140

ECB's wait-and-see approach doesn't point to much upside for the euro

The January meeting of the European Central Bank should have a little impact on the euro. No new economic projections will be published and the board is unlikely to change its risk assessment (see ECB Preview for details). An official announcement that the bank is launching its strategic review has been well-flagged and is not likely to affect the euro materially either.

With euro rates deeply negative and little prospect of a turnaround in the near-term (for this to happen, we would need to see a more pronounced rebound in eurozone data and the ECB dropping its easing bias on rates – which is unlikely at this point, and features as a risk scenario in our ECB crib sheet), the outlook for the euro remains unattractive and the currency is likely to continue to be used as the funding vehicle of choice for carry trades.

Euro shows no sign of recovery

We continue to see EUR/USD risks as skewed to the downside in coming weeks (towards / modestly below the 1.10 level) should the use of the euro as a funding currency become even more pronounced or global economic data disappoint. Talk of a Republican tax cut 2.0 may also add to a downward EUR/USD trend.

Even if the global economic outlook improves and this positively affects data from the euro area (the eurozone is a big open economy), this wouldn't necessarily be overly positive for EUR/USD because while it would signal a less dovish ECB (perhaps encouraging the bank to reconsider its easing bias) it would also likely be accompanied by a hawkish re-pricing of the Federal Reserve's outlook, where close to one 25 basis point cut is currently priced in for this year.

With EUR/USD showing no urgent sign of mis-valuation (as per 2020 FX Outlook, our Behavioral Equilibrium Exchange Rate model suggests the cross is currently fairly valued after the non-negligible decline in EUR/USD fair value since 2017), we see a limited upside potential for the cross at this point.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Disclaimer