EUR and ECB Crib Sheet

With expectations running high, it will be very difficult for the ECB to reverse the EUR/USD uptrend. The weak dollar dynamics are too powerful and despite more ECB easing expected this week, EUR/USD should head higher next year. We target EUR/USD 1.25 in 2021, with a strong upside risk to 1.30

Expectations are running high

With President Lagarde building high expectations in the October meeting and largely pre-committing to the ECB easing in the December meeting, it will be a very difficult task for the central bank to weaken the euro. If anything, there is a risk is that that the press conference bias pushes EUR higher, particularly if the forward guidance beyond the December easing package is not overly strong.

In fact, we look back to the ECB meeting in September 2019 for guidance / road map. At that time, the ECB did not exceed the high expectations built up prior to the meeting and failed to push EUR/USD lower back then despite it cutting the depo rate and restarting QE. In the absence of a rate cut or meaningfully larger asset purchases, the impact of the upcoming ECB easing on EUR is likely to be limited.

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rate, QE & PEPP	Exchange rate comments	EUR/USD
Current stance	Inflation outlook "surrounded by an exceptional degree of uncertainty "	"Risks to the economic outlook tilted to the downside"	Depo at 0.50%, PEPP and PSPP unchanged	The GS is "very attentive" to the exchange rate	
Dovish	Inflation outlook for next years has worsened, the ECB "highly concerned"	High degree of uncertainty and risks clearly tilted to the downside	**Rate cut** to -0.60%, Top up by 750bn in PEPP, by 20bn pm in APP & NO tiering	Stronger euro **weighs on** growth and CPI outlooks	1.1900
ING Base Case (neutral)	Recent data suggest **only gradual increase in** CPI	**Recovery will gain momentum** over the summer but high uncertainty	Top up by **500bn in PEPP**, by **20bn pm in APP**, extension of **TLTRO**, more **tiering**	Exchange rate is not a target but the ECB is **attentive**	1.2100
Modestly hawkish	"Recent data have confirmed ECB's base case"	"Recent data confirm base case of gradual recovery"	Top up by 500bn in PEPP, extension of TLTRO, more tiering	Exchange rate is not a target but the ECB is **attentive**	1.2250
Very hawkish	Risks to the inflation outlook are balanced	Risks to the economic outlook are balanced	Top up by 500bn in PEPP only	EUR strength having a limited impact on econ / CPI outlooks	1.2400

Source: ING

It will be difficult to over-deliver

In our view, the mix of an increase in the Pandemic Emergency Purchase Programme by up to EUR500bn, an increase of the monthly Asset Purchase Programme purchases from EUR20bn to EUR40bn (open-ended), an extension of Targeted Longer Term Refinancing Operations, an increase in the tiering facility and potentially including Fallen Angels into the corporate bond purchasing programme (see the ECB Preview for more details) won't be enough to push EUR/USD persistently lower and outweigh the very strong bearish USD dynamics (which is the key driving factor behind our bullish EUR/USD forecast). As per our 2021 FX Outlook: Back on track, we target EUR/USD 1.25 in 2021, with a strong upside risk to 1.30.

ECB attentive to the euro, but no aggressive verbal intervention expected

As for the exchange rate, with the trade weighted EUR not exceeding its summer highs (which in the time led to verbal interventions from some ECB officials) and just modestly trading above its 4-month average (ie, 0.5% higher), it looks to be too soon for the ECB to embark on more aggressive verbal intervention. The ECB being "very attentive to the exchange rate" is likely to be reiterated in the press conference, but it should fall short of Trichet's brutal-like comments.

As for the short-term valuation, our models suggest no meaningful EUR/USD mis-valuation, with the pair only trading modestly above its short-term fair value and comfortably within its 1.5 standard deviation band.

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