

EUR and ECB Crib Sheet: Hawkish expectations vs Lagarde's patience

We think that ECB President Christine Lagarde will stick to the view that inflation will ease later this year and keep pushing back against a 2022 hike, which could disappoint the market's hawkish expectations and send EUR/USD back to the 1.1200 support



Christine Lagarde,
president of the
European Central Bank

What we expect from the ECB meeting

This week's European Central Bank (ECB) rate announcement is highly unlikely to bring any changes to the Bank's policy. Instead, most focus will be on how the ECB addresses the inflation risk and whether there will be any tweaks to rates and quantitative easing (QE) guidance.

Here is a detailed article on what we expect from the meeting: [“ECB preview: How to avoid jumping from patience to panic”](#). In a nutshell, we think that President Christine Lagarde will carefully avoid sounding too alarmed on inflation, and along with the acknowledgement that price pressures are set to remain elevated for most of 2022, the view that core will ultimately ease from late-2022 onwards should remain central. Accordingly, Lagarde should continue pushing back against speculation over a rate hike in 2022.

We look at different scenarios and implications for euro (EUR)/US dollar (USD) – which we discuss in

greater detail in the next paragraph – in the chart below.

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rates	QE and PEPP	EUR/USD
Current stance	"Inflation to ease in '22, settle below 2% over the projection horizon"	"Expecting recovery to continue, driven by robust demand"	Depo at -0.50%. No hikes before 2023.	PEPP end in March. APP up and then scaled back, €20bn p.m. from October	
Dovish	Inflation to correct in 2022, undershoot target in the projection horizon.	Energy prices and Omicron pose material downside risks to recovery	No hikes in 2022. First hike shortly after end of APP	No further tapering discussion, APP may be extended into 2023.	1.1150
ING Base Case (neutral)	Higher vigilance on inflation, but core to ease from late 2022 onwards.	Recovery sustained, even if energy prices and Omicron pose some risks	No hikes in 2022. First hike shortly after end of APP	No change. But ECB on track to end purchases in 2022	1.1200
Hawkish	Inflation no longer expected to ease in 2022	Recovery sustained, very limited downside risks	Even if rate guidance remains unchanged, implicit hints at a 2022 hike	GC actively discussing the end of APP in 2022	1.1350
Very hawkish	Inflation seen persistently above target over the projection period.	Strong recovery, upside risks and wage pressure	First rate hike likely in 4Q22	Announcement that APP will end in 4Q22	1.1500

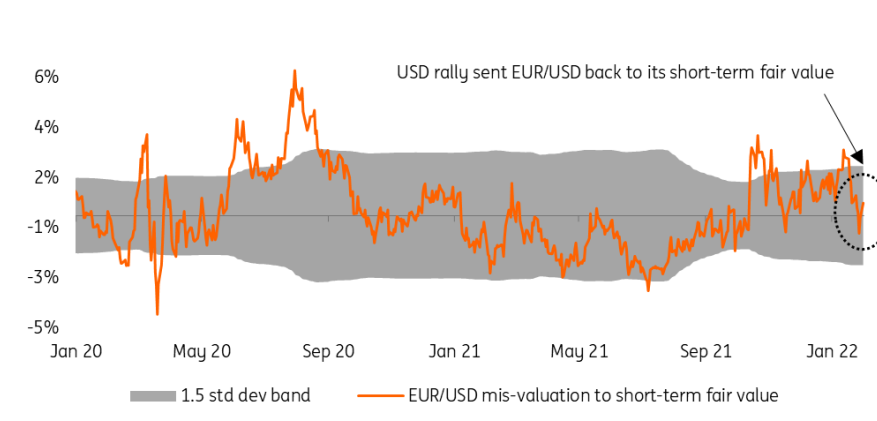
Source: ING

EUR/USD: Downside risks from hawkish expectations

EUR/USD jumped along with the eurozone's bond yields on Monday as inflation numbers in Germany beat expectations and suggested prices may prove stickier than what the ECB is currently forecasting. We think this notion, along with the ongoing softening of USD momentum, can offer a floor to EUR/USD into the ECB meeting, as markets price in a greater probability of a hawkish shift.

Indeed, some of those hawkish expectations are already embedded in asset prices, as markets are currently pricing in the start of the ECB's tightening cycle in 4Q22, despite the ECB's forward guidance signalling no rate increases until 2023.

As discussed above, we think that patience will prevail over panic in the ECB's message when it comes to inflation, and given the bar for a hawkish surprise is placed quite high after this week's consumer price index figures, we expect EUR/USD to give up some of its recent gains after the ECB announcement. We expect the pair to pull back to the 1.1200 support, with any recovery in the dollar set to trigger a break below that level.



Source: ING, Refinitiv

It is important to notice that the dollar rally in the second part of January was quite justified by fundamentals (in particular, interest rate differentials) and – as shown in the chart above – it brought EUR/USD from overvalued to fairly valued territory. Incidentally, EUR/USD positioning had advanced into net-long territory before last week's dollar rally, which suggests that position-squaring-related upside risk for the pair is now limited.

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