

# EUR & ECB crib sheet: Hawks can't lend their wings to the euro

Here are our four scenarios for the European Central Bank and their related implications for the currency and rates markets. A 75bp ECB hike is our call; it's what markets are expecting too. Attaching a hawkish tone to the hike should – like in previous instances – fail to offer substantial and long-lasting support to the euro

## EUR and ECB crib sheet

|                                | Inflation outlook   | Growth outlook  | Interest rates   | Quantitative easing   | EUR/USD (0.98) | 10Y Bund (2.32%) |
|--------------------------------|---|---|--|---|----------------|------------------|
| <i>Current stance</i>          | Inflation far too high & likely to stay above target for an extended period | Economy expected to stagnate later in the year and in the first quarter of 2023 | Depo at 0.75%. Future rate path will be data-dependent                   | APP and PEPP in reinvestment phase. TPI can be triggered but has conditionality |                |                  |
| <b>Dovish</b>                  | Upside risks in near term, but medium-term infl. may return to target       | High risk of a much sharper/longer lasting economic slowdown                    | <b>50bp hike</b><br>Worsening outlook suggests slower pace of tightening | Increased probability of activating TPI   | 0.96           | 2.10%            |
| <b>ING Base Case (neutral)</b> | Infl. to stay high, more hikes needed to bring medium term back to target   | Risks to the downside, particularly in the near term                            | <b>75bp hike</b><br>Maintaining a fully data-dependent approach          | Unchanged   | 0.97           | 2.25%            |
| <b>Moderately hawkish</b>      | Inflation will likely be higher than forecasted over medium term            | Downside risks to the outlook slightly abated since September                   | <b>75bp hike</b><br>Hinting at more large hikes ahead                    | Hints that balance sheet reduction is being discussed                           | 0.99           | 2.30%            |
| <b>Very hawkish</b>            | Inflation seen persistently above target in the projection period           | Fiscal support and lower gas prices suggest quick economic rebound              | <b>100bp hike</b><br>More hikes to come                                  | Balance sheet reduction will start early in 2023                                | 1.00           | 2.40%            |

Source: ING

## We expect the ECB to hike by 75bp at the October meeting

This has become a consensus call in recent weeks, and markets are fully pricing in such a move. This means that – barring a surprise on the size of the hike – the market reaction will depend on the ECB's stance on:

- **Further rate rises:** any tweaks to the meeting-by-meeting data-dependent approach and/or references to the terminal rate
- **Changes in the inflation and growth outlook**
- **Discussion over quantitative tightening**

In our [ECB preview](#), we highlight what we expect to hear on those topics this week. Here you can see where we're coming from; it's our usual pre-meeting scenario analysis, where we look at implications for EUR/USD and the rates market to those different potential outcomes.

## A 75bp hike will not be a game-changer for EUR/USD

As shown above, we see limited upside risks for EUR/USD in the aftermath of the ECB announcement. This is mainly due to the weakened correlation between short-term rates and currency dynamics in the eurozone. This means that additional tightening being priced into the EUR curve on the back of a hawkish statement still looks unlikely to offer a sizeable, and above all, sustainable support to the euro.

This was indeed the case in the past few meetings, where the ECB consistently surprised on the hawkish side but that did not avert a euro depreciation. A tightening-based FX protest (against the inflationary weak euro) is simply not working in the current market environment.

In line with our expectations of a stronger dollar, as the Fed keeps tightening policy and keeps risk sentiment weak into the new year, we expect a drop below 0.9500 in EUR/USD by the end of this quarter.

### Author

#### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

#### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

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