

## EUR & ECB crib sheet: Lifting the euro is a hard task

A 25bp rate hike and openness to a 50bp move in September may fall slightly short of market expectations and add some pressure to the euro this week. The European Central Bank is unhappy with a weak euro, but its ability to offer sustainable support to the currency may continue to prove limited



### What to expect on Thursday

As discussed in our [July ECB preview](#), we expect policymakers in Frankfurt to deliver the previously announced 25bp rate hike on Thursday and leave the door open for a 50bp increase in September. The overnight index swaps market is pricing in 30bp for this week and nearly 200bp of tightening by June 2023. We suspect that the Bank's message may fall slightly below market expectations, and trigger some dovish re-pricing across the EUR curve.

The deployment of the anti-fragmentation tool will be all the more interesting as the recent Italian political crisis (which [we analysed in detail here](#)) has increased the chances of a sharp re-widening of Italian sovereign spreads. Here, the details about the conditionality to access the anti-spread tool will be key and may drive part of the market's reaction.

We identify four different scenarios (with the second being our base case) ahead of this week's ECB policy announcement, and we include our estimated impact on EUR/USD and German 10Y yields.

### Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rates	Quantitative easing		
Current stance	Headline inflation slightly above target at the end of projection horizon	Some factors keep weighing on outlook, but growth to pick up again	Depo at -0.50%. September hike can be larger than 25bp. Gradual hiking after	APP and PEPP in reinvestment phase. But PEPP flexible if fragmentation	EUR/USD (1.01)	10Y Bund (1.18%)
Dovish	Upside risks in near term, but medium-term infl. will return to target	Stagflation risk has risen significantly	25bp hike. Worsening outlook suggests no more than 25bp in Sept.	Fragmentation tool putting limited conditionality. Unlimited.	0.99	1.00%
ING Base Case (neutral)	Infl. to remain high, decline to slightly above target in medium-term.	Mounting downside risks, but conditions still in place for growth.	25bp hike. Signalling 50bp option on the table for Sept.	Fragmentation tool with some conditionality. Few details.	1.00	1.15%
Hawkish	Medium-term inflation outlook even higher than June projections.	Same downside risks, but conditions in place for growth.	50bp hike. 50bp more in September highly likely.	Fragmentation tool with some conditionality. Size limited.	1.02	1.25%
Very hawkish	Inflation seen persistently above target in the projection period	Stressing that downside risks are temporary, outlook strong beyond that	50bp hike, 50bp or 75bp in September.	Fragmentation tool with very strict conditionality. Size limited.	1.03	1.30%

Source: ING

## Fighting a weak euro is not easy

There is no doubt that the ECB is unhappy with the recent weakness of the euro – not only against the dollar, but on a trade-weighted basis. Recent hawkish surprises by the ECB have, however, failed to offer sustained support to the euro, and we suspect that a larger-than-expected move (a 50bp rate hike) or more hawkish-than-expected forward-looking language may fail to generate enough lift to the euro.

This is especially due to the mounting downside risks in the eurozone, mostly related to the threat of a gas supply crunch in the coming months (or during winter) and more recently about Italy falling back into political uncertainty.

Our base case for EUR/USD is that it can re-test parity this week – with the ECB potentially being a trigger – and that it may only come back to levels above 1.0300 once the dollar loses some momentum (which would require some stabilisation in risk sentiment) and markets feel somewhat comfortable with the magnitude of the economic downturn priced into European assets.

## 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)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).