

EUR & ECB Crib Sheet: Little new news for the euro

No new measures from the ECB are expected at the July meeting. The impact on the euro should thus be limited. Near-term, the more important driver is the progress on an EU Recovery Fund. The ECB has fully compressed the EUR risk premium and with a soft dollar environment to unfold further in coming months, EUR/USD should head higher, above 1.15 this summer



German Chancellor Angela Merkel, European Central Bank President Christine Lagarde, and European Council President Ursula von der Leyen

Source: Shutterstock

Little new news from the ECB

The European Central Bank meeting this Thursday should have a fairly limited impact on the euro (as per the scenario analysis in Figure 1). No new measures are expected to be announced (following a top up of the Pandemic Emergency Purchase Programme at the June ECB meeting), the economy is gradually recovering and the meeting should be more about testing President Christine Lagarde's communication skills (see [ECB preview: The breather meeting](#) for details) rather than any new measures.

Figure 1: The ECB Crib Sheet

Scenario analysis: How to position for Lagarde's alternatives

| | Inflation outlook | Growth outlook | Interest rate & QE decision | PEPP programme | EUR/USD |
|--------------------------------------|--|--|---|---|---------|
| Current stance | Inflation outlook "surrounded by an exceptional degree of uncertainty" | "Activity is expected to rebound in the third quarter" | Deposit rate at 0.50%, regular EUR 20bn QE pm. & temporary EUR 120bn until year end | An overall envelope of EUR 1350 billion until end June 2021 | |
| Rise in risk premium | Inflation pick up far too slow to bring CPI to the target | Recent data don't suggest a sustained easing of risks | Downside risks still present, further depo cuts on cards | Legal issues suggest an earlier end to PEPP | 1.1200 |
| ING Base Case | Recent data suggest the CPI pick up will take longer | Recent data suggest significant slowdown in activity | No change, forward guidance for lower rates for longer | No change, ECB retaining flexible approach to PEPP | 1.1350 |
| Decline in risk premium | Confident that underlying inflation will pick up | Downside risks have started to disappear | No change, forward guidance for lower rates for longer | The GC contemplating another increase in PEPP | 1.1400 |
| Large decline in risk premium | Risks to the inflation outlook are balanced | Risks to the economic outlook are balanced | No change, hint at another easing of TLTRO conditions | The GC signalling an increase in PEPP for Sep/Oct meeting | 1.1450 |

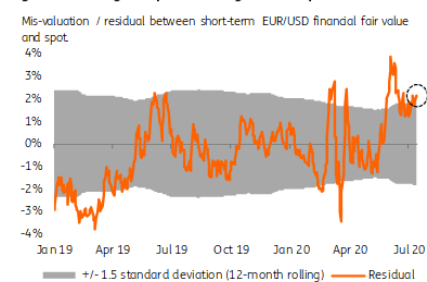
Source: ING

EUR risk premium fully compressed

So far, the ECB measures have managed to fully compress the EUR risk premium, with EUR/USD in fact trading expensive vs USD on a short-term bias (as per our short-term financial fair value model in Figure 2). Indeed, the options market does not show any signs of stress (Figure 3) while the speculative community remains long EUR/USD (see [FX Positioning: EUR's primacy solid ahead of key events](#)).

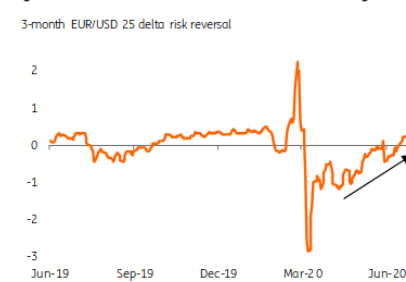
The forthcoming ECB meeting should not change much, with the discussion/progress on an EU Recovery Fund being a more important short-term driver for the EUR/USD. Any potential progress on the recovery fund at the EU summit (starting on Friday) should translate into support for EUR/USD for the remainder of the week, with the ECB meeting playing second fiddle.

Fig 2 ECB fully compressed any EUR risk premium



Source: ING

Fig 3 EUR/USD risk reversal continue normalizing



Source: ING, Bloomberg

EUR/USD heading higher this summer

We continue to see EUR/USD breaking the 1.15 level this summer and moving towards 1.20 by year-end as the expected soft US dollar environment pushes the cross higher. The ECB's measures, which have reduced the risk premium for the euro, should facilitate this move but the weak dollar environment should be the prime catalyst behind the appreciation of the cross.

Author

Carsten Brzeski

Global Head of Macro

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 <http://www.ing.com>.