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

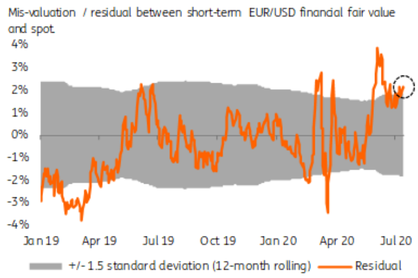
Source: ING

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).

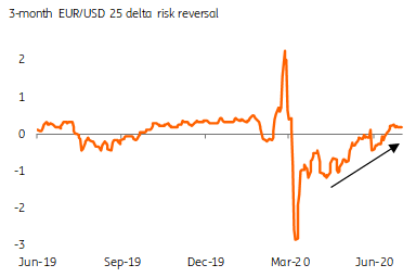
The forthcoming ECB meeting should not change much, with the discussion/progress on an EU Recovery Fund being a more important short-term driver for the EUR/USD. Any potential progress on the recovery fund at the EU summit (starting on Friday) should translate into support for EUR/USD for the remainder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

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