EUR & ECB Cribsheet

With the euro below its multi-quarter average and the European Central Bank already announcing front-loaded purchases in March, the April ECB meeting should have a muted impact on the single currency. Instead, the focus will be on improving eurozone data in coming months, and with EUR/USD still trading cheap, further upside lies ahead

Scenario analysis: How to position for Lagarde's alternatives

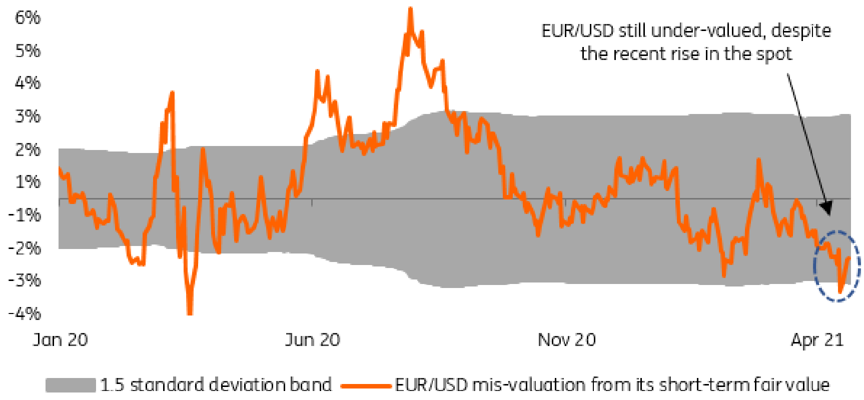
	Inflation outlook	Growth outlook	Interest rate, QE & PEPP	Exchange rate comments	EUR/USD
Current stance	"Underlying price pressures are expected to remain subdued overall"	"Risks to the economic outlook have become more balanced "	Depo at 0.50%, PEPP at €1,850bn until March 2022 & APP at €20bn pm	The GC monitors developments in the exchange rate	
Very dovish	ECB is "highly concerned" about too low 2022 inflation	High degree of uncertainty and risks clearly tilted to the downside	ECB increasing the PEPP envelope to keep higher pace of purchases for 2H21	The level of EUR **forcing** the ECB to **adjust policy instruments**	1.1700
Dovish	Recent data suggest **a return to low core inflation in 2022**	**Recovery will gain momentum** over summer but high uncertainty	No change, but **intention to increase the PEPP** size communicated	Recent EUR correction not enough to reduce risks to CPI outlook	1.1850
ING Base Case (neutral)	"Somewhat higher inflation this year on back of **one-off factors**"	"Recent data confirm base case of **gradual recovery**"	**No change.** The PEPP size to increase if necessary	**No change**	1.2000
Hawkish	Risks to the inflation outlook have become more balanced	Economic recovery in H2 could be stronger than anticipateded	GC assessment of a **declining future need to ease policy** further	Exchange rate no longer warrants monitoring	1.2200

Source: ING

No surprise from the ECB in April

With the relatively exciting March ECB meeting having a fairly limited impact on EUR (frontloaded purchases from the Pandemic Emergency Purchase Programme in the second quarter were more of a fixed income story), the April ECB meeting should be a non-event for the euro. Limited new news and the ECB's confirmation that it will look through any temporarily rise in CPI (due to one-off factors such as oil prices – see ECB Preview for details) suggest a muted impact on the euro tomorrow (as per the scenario analysis above). With the trade-weighted euro below its nine-month average (i.e. since the ECB started its verbal intervention last summer) there is a little need for the ECB to lean against the common currency.

EUR/USD still screens as undervalued on short-term basis



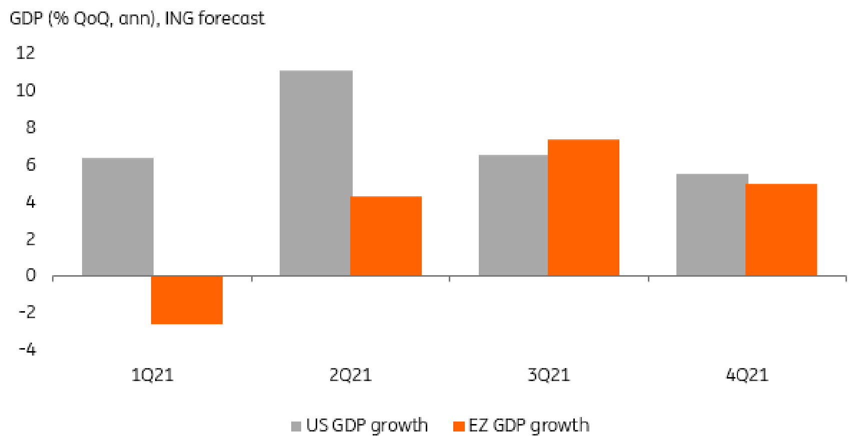
Source: ING, Refinitiv

EUR still trading in undervalued territory

While the ECB is still cautious and unlikely to provide a positive catalyst for EUR any time soon, the EUR/USD uptrend which started this month should remain in place. Plenty of bad news has now been priced in, the currency has been trading with a persistent risk premium over the past few months (see chart above) and despite the recent rise, EUR/USD still screens cheap based on our short-term financial fair value model.

The first quarter was rather dismal for eurozone economic data but this is likely to change in coming months as the pace of vaccination picks up. Improving eurozone data should translate into some upside for the euro. Indeed by summer, eurozone growth should be more synchronised with the US (particularly throughout the second half of the year – Fig 3) and this should provide support to the euro.

Eurozone growth to start catching up with the US in 2H21



Source: ING

Fading USD strength to facilitate higher EUR/USD

Equally important, the dollar strength observed during the first quarter of this year appears to be fading and USD no longer positively reacts to solid US data points. This suggests that plenty of good news is already priced into the dollar (as opposed to plenty of bad news being priced into the euro). This, coupled with the Federal Reserve presiding over deeply negative front-end US real rates (as US CPI inflation will rise meaningfully this quarter and the Fed sticks to its Average Inflation Targeting framework), should weigh on the dollar, which has already seen a meaningful positioning adjustment (with the overall USD speculative positioning now being close to neutral).

All this suggests higher EUR/USD in coming months and we expect the pair to reach and break the 1.25 level this summer.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Disclaimer