EUR & ECB Cribsheet for September meeting

We see a high bar for the ECB to attempt to forcefully talk down the euro. It is not time yet, while tools to credibly do so seem limited. As it is also too early for a PEPP extension, the EUR should sail through the September ECB meeting. And given the structural USD downtrend, our EUR/USD medium-term outlook remains bullish

Source: Shutterstock

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rate, QE & PEPP	Exchange rate comments	EUR/USD
Current stance	Inflation outlook "surrounded by an exceptional degree of uncertainty"	"Activity is expected to rebound in the third quarter"	Depo at 0.50%, QE & PEPP commitments unchanged	No prior reference to the euro	
Very dovish	Inflation projected at 1% in 2022. ECB "highly concerned"	High degree of uncertainty and risks clearly tilted to the downside	Downside risks still present, further depo cuts on cards	EUR strength considered as **"brutal"**	1.1500
Dovish	Recent data suggest the **CPI pick up will take longer**	Recent data suggest **significant** levelling off	No change, but **hints at eventual PEPP extension**	Stronger euro **weighs on** growth and CPI outlooks	1.1700
ING Base Case	Downward revision to CPI forecast by 0.2% for 2021 & 22	Downside risks have started to disappear	No change, forward guidance for lower rates for longer	Exchange rate is not a target but ECB **monitors closely**	1.1850
Hawkish	Risks to the inflation outlook are balanced	Risks to the economic outlook are balanced	No change, current envelope for PEPP more than sufficient	EUR strength having a limited impact on econ / CPI outlooks	1.2000

All eyes on focus is on the euro comments

Were it not for the strong euro, the September European central bank meeting on Thursday would probably have been a non-event.

Growth outlook hasn't deteriorated versus the last forecast (particularly in light of the prior pessimistic ECB projections) and although the CPI forecast is likely to be revised lower, the monetary policy set up is already very loose (i.e, material asset purchase via QE and PEPP, and deeply negative rates), raising the bar for differentiating and impactful additional easing steps.

Read Carsten Brzeski's ECB preview for more on inflation forecasts

Too early for ECB to forcefully talk down the euro...

While the some of ECB Council member's comments showed an uncomfortableness with the recent EUR strength, we think it is too early for the ECB to forcefully talk down the euro this week.

We don't look for Trichet-like comments on a "brutal" EUR appreciation. Rather, President Christine Lagarde may highlight that the central bank monitors the euro closely while reiterating that the exchange rate isn't seen as a target. We also don't expect the ECB to hint at the extension of the PEPP programme beyond 2021 just yet, suggesting that EUR/USD should not be affected much by the meeting.

... and if attempted, it will be difficult to talk it down

Although the euro is on the ECB radar, we don't expect potential verbal interventions to be strong enough to send EUR/USD materially and persistently lower as (a) there is not much the ECB can do (i.e, the depo rate is already negative, asset purchases are already large, and while the PEPP extension beyond mid-2021 is a possibility, it is unlikely to come this week and is in fact already expected by the market to eventually come in one of the next ECB meetings) and; (b) the case for a structural USD bear trend remains strong, with the Fed's adoption of the Average Inflation Targeting strengthening the narrative for low US real rates for longer – which should, in our view, be the key driving force behind the USD weakness in quarters to come.

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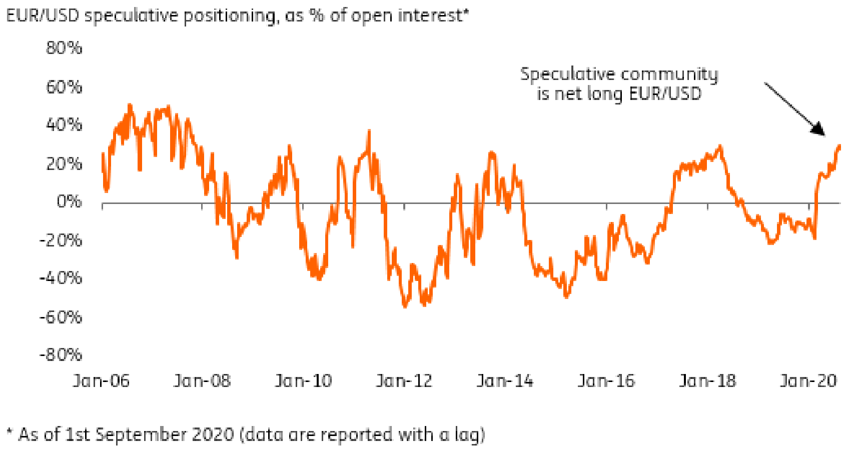
Speculative community has built significant net EUR/USD longs



Source: ING, CFTC

Into the year-end, the vigilant ECB, the risk surrounding the November US presidential elections and one-way net-long EUR/USD positioning should tame the euro upside.

But as the USD bear trend continues into mid-2021, EUR/USD is likely to push to/above the 1.25 level next year.

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