EUR & ECB Cribsheet

The conclusion of the ECB strategic review means the distribution of probabilities is skewed to lower EUR/USD. The more dovish bias would imply a total reduction of the monthly purchases in 2022, which will be less than previously expected keeping EUR/USD negative – both tomorrow and in 2022 when the ECB-Fed divergence should fully materialise

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rate, QE & PEPP	Exchange rate comments	EUR/USD
Current stance	"Price pressures to remain subdued overall"	"Risks surrounding the growth outlook broadly 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 2023 inflation	High degree of uncertainty and risks clearly tilted to the downside	No change. GC signaling no tapering this year and early next year	The level of EUR to **force** the ECB to **adjust policy instruments**	1.1600
ING Base Case (Dovish)	Recent data suggest **a return to too low core inflation in 2022**	**Recovery will gain momentum** over summer but high uncertainty	No change, but **total reduction in QE in 2022** to be **less than expected**	No change	1.1700
Hawkish	Somewhat higher inflation this year on back of **one-off factors**	"Economic recovery in H2 could be stronger than anticipated"	**ECB strategic review to have no impact** on total QE reduction in 2022	No change	1.1850
Very hawkish	Vigilant about possible second round effects	Recent data confirm that medium-term risks are tilted to upside	Decision to taper PEPP from Q4 onwards	Exchange rate no longer warrants monitoring	1.2100

Source: ING

What was supposed to be a non-event ECB July meeting has turned into a key focus point of the week following the release of the ECB's strategic review.

With the ECB shifting the inflation target from 'below, but close to 2%' to '2%' with a commitment to symmetry, the new strategy can be interpreted as either a formalisation of what it has been doing over the last few years anyway or a step towards more dovishness, as 2% implies a more resolute effort (see ECB Preview for more details).

This means the distribution of probabilities is skewed to lower EUR/USD. No change in the ECB bias is unlikely to be enough to send the euro higher as the ECB will remain cautious, and the Fed is much closer to starting the monetary policy normalisation process (both on the QE side and the interest rate side). At the same time, any ECB shift towards the dovish interpretation of the strategic review would underscore the recent downward EUR/USD trend.

While not a discussion for this week, the ECB dovish bias would suggest that the total reduction of the monthly purchases in 2022 will be less than previously expected.

This would further underscore the diverging trend between the ECB and the Federal Reserve and put a lid on any EUR/USD upside while exposing EUR/USD on the downside next year when the Fed should be moving closer to the interest rate hikes.

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