January ECB cheat sheet: Expect the expected

ECB members have given strong hints that this Thursday's decision will be a 25bp rate cut, and we don't think this will be a market-rocking event. Our baseline is that a reiteration of the broadly dovish message can pave the way for lower eurozone rates. While the ECB remains a negative for the euro, the dollar correction might have a bit more to run

	Inflation outlook	Growth outlook	Interest rates	EUR/USD (1.052)	10Y Bund (2.53%)
Current stance	Inflation to fluctuate in the near term, settle around 2% in medium term	Economic activity to be supported by rise in real wages. Risks to the downside	Depo at 3.00%. Data-dependent, meeting-by-meeting approach		
Dovish	Risks of inflation undershooting target in 2025 and beyond	US protectionism a tangible risk to growth, may call for frontloaded cuts	**25bp cut.** Larger cut was on the table. Strong hints of more cuts to follow	1.045	2.40%
Moderately dovish ING base-case	Overlooking sticky inflation of past months. Expecting 2% this year	Unchanged. Balance of risks for growth remains tilted to downside	**25bp cut.** Unchanged dovish-leaning message. Data dependency	1.050	2.50%
Neutral	Greater near-term upside risks for infl. but medium-term view unchanged	Some tentative improvement in PMIs, but US tariff risk tangible	**25bp cut.** Stressing data dependency, slightly more cautious on easing	1.058	2.55%
Hawkish	Higher oil prices can lead to upward revision in inflation projections	Downplaying US protectionism risk, upbeat view on growth	**25bp cut.** Market expectations for easing are too dovish	1.063	2.65%

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This article is part of our European Central Bank coverage. Please refer to our January ECB preview for details.

This Thursday's ECB decision will almost certainly be a 25bp rate cut. Governing Council members have given very strong hints that rates would be lowered again in their latest comments, most recently in Davos. Our baseline view is that President Christine Lagarde will broadly repeat December's communication and her Davos forward guidance. That includes reiterating that rates wil remain in restrictive territory and while not pre-committing to a specific easing path, sticky December inflation should not prevent the policy message from staying dovish, signalling further gradual easing this year.

Rates: Risks of lower yields

The rates market is viewing a cut at the upcoming meeting as a near done deal. The same goes for the following March meeting, with a total of 47bp of easing discounted by then, which would take the deposit facility rate to 2.5%. This is all in tune with comments from ECB officials pointing to further gradual easing. But it's beyond the first quarter that the outlook gets less certain. The market sees the ECB at 2.25% in June with a decent chance of another cut to 2% before the end of the year.

Expectations late last year had seen the ECB cut down to at least 1.75%. Since then, to a degree spillover effects from the US but also a refocus on stickier inflation and energy price dynamics had turned the pricing more hawkish. After Friday’s better-than-expected eurozone PMIs, markets found another reason to price a more cautious advance by the ECB as the neutral territory is approached. But we have already seen some expression of doubts surrounding the December forecasts in the ECB minutes. More hints along those lines could push rates lower again.

Overall, we believe the balance of risks points towards lower rates again at these levels. With the ECB only starting to enter the broader range of neutral estimates, the expectations of the next couple of cuts will serve as an anchor. The upside appears more capped by the uncertainty stemming from US policies.

FX: Euro not counting on the ECB for another rally

EUR/USD is retesting levels above 1.050 as markets have now priced out a good portion of the protectionism risk premium associated with President Donald Trump’s tariff threat. Things on this matter can change overnight, as Trump often switched from friendly to hostile towards his trading partners without warning, but the longer eurozone and China are spared tariffs, the harder it will be for USD to regain momentum.

If the tail risk of US protectionism is getting thinner, there are lingering dampening eurozone-specific factors that will, in our view, prevent the euro from rallying much beyond the positioning re-adjustment. Eurozone growth remains concerning and political events this year can easily unnerve markets. Most importantly, we expect Thursday's ECB decision to show a resolutely dovish Governing Council that will keep a lid on any hawkish repricing of rate expectations even if inflation proves sticky at the next release.

We expect EUR/USD to hover around 1.050-1.060 in the short term, although the ECB could trigger a small correction on Thursday.

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

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

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