

The ECB's Dashboard: Taper auto pilot

Market volatility, Italian fiscal policies and low core inflation will do little to divert the ECB from its taper plans. The auto pilot, turned on in June, should stay on. The reduction in net QE purchases has been well telegraphed and should not surprise anyone. Look for a limited effect on both FX and bond markets



Source: Shutterstock

Scenario analysis: How to position for Draghi's alternatives

Current stance	Inflation outlook	Growth outlook	Forward rate guidance	QE taper guidance			
	EUR/USD	2-year Schatz	10-year Bund				
Dovish	"Underlying inflation is expected to pick up"	"The risks... to growth outlook are broadly balanced"	Rates to remain "at present levels at least through the summer of 2019"	QE reduced after September and ended in December 2018	1.14	-5 bp	-10bp
ING Base Case	No revision of CPI forecast	Risks remain broadly balanced	No change in the "through summer" guidance	Announcement to reduce QE to 15bn pm as signalled	1.16	+0 bp	+0 bp
Hawkish	Even greater confidence of CPI converging to target	Upward revision of 2019/20 growth forecasts	June/July deposit hike cannot be ruled out	Hints that QE could end before year-end	1.18	+5 bp	+10 bp
Very hawkish	Upside risks" to the inflation outlook	Risks to growth outlook are to the "upside"	Balance of risks point to hike before the summer	Signal that reinvestments could end in 1H 2019	1.22	+10 bp	+15 bp

Source: ING

ECB remains on auto pilot towards an end of QE by year-end

When does a central banker know that he has done an excellent job? When QE can be brought to an end and hardly anyone seems to care. This definition characterises the ECB's recent and next steps.

As market volatility on the back of trade tensions, Turkey and Italian fiscal policies has not left any significant marks on the Eurozone economy, the ECB will in our view announce the next step of its dovish tapering on Thursday: a reduction of the monthly QE purchases to EUR15bn from EUR30bn currently.

We don't expect the latest round of ECB staff projections to deliver any new insights on growth and inflation. Our main focus will be on the ECB's forecast for core inflation, which up to now has been subject to extreme optimism but has shown very little progress.

With a reduction of the QE purchases, the ECB remains on auto pilot towards an end of QE by year-end. Therefore, there is very little reason to change the communication or forward guidance.

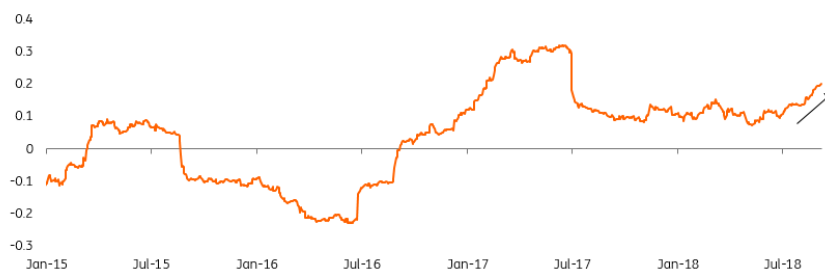
FX markets implications

EUR/USD should be largely unaffected by this week's ECB meeting as (a) the taper autopilot has been clearly and fully communicated (thus no surprise there vs market expectations); (b) the firm forward rate guidance on the ECB deposit rate makes any potential ECB interest rate re-pricing a story for 2019 rather than this year. As a result, the ECB is unlikely to provide a catalyst for meaningful EUR moves this week.

Rather than relative monetary policy outlook (on the USD side, the Fed outlook for 2018 is fairly priced), the main driver behind the EUR/USD price action remains the general risk environment and the spectre of trade wars. At this point (and despite the Eurozone current account surplus) this is a negative for EUR/USD given the pro-cyclicality of the EUR/USD (see chart below), the openness of the Eurozone (EZ) economy (vs the relatively closed US economy) as well as the threat of EZ specific tariffs coming from the US administration.

EUR/USD positively correlated with risk

12-month rolling EUR/USD correlation with risk (MSCI World equity index), daily data



Source: ING, Bloomberg

Bond markets implications

The reduction in net QE purchases has been well telegraphed and should not surprise anyone. If anything, some faint hopes that Draghi could adjust the anticipated path to the risk environment,

which would need to be priced out. In that regard trade, EM concerns and the Italian budget and should remain the main drivers for rates this coming week.

Authors

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.