Report | 22 January 2018

FX

ECB Crib Sheet

How markets could react to Thursday's ECB meeting.

Download the print-friendly infographic below

Source: Shutterstock

Scenario analysis

	Inflation outlook	Growth outlook	Reference to the EUR level	*QE taper guidance*	EUR/USD	2-year Schatz	10-year Bund
Current stance	"Underlying inflation is expected to rise gradually"	"The risks... to growth outlook are broadly balanced"	"Volatility in exchange rate is source of uncertainty ..."	QE is "not going to stop suddenly"			
Very dovish	Transitory factors keeping **inflation low** are here to stay	Risks to the growth outlook **to the downside**	**Unwarranted tightening** of monetary conditions	GC considering QE extension beyond Sep 2018	1.20	-5 bp	-10bp
ING Base Case	Underlying inflation still expected to rise **gradually**	Risks still **broadly balanced**	Exchange rate is a **downside risk to growth** outlook	GC's majority **retains the open-endedness** feature of QE	1.22	-5 bp	-5 bp
Hawkish	**Even greater confidence** of CPI converging to target	**Recovery improved,** risks still balanced	The EUR level is a **reflection of fundamentals**	GC members **not in agreement** on the open-endedness	1.24	+5 bp	+10 bp
Very hawkish	**Upside risks** to the **inflation outlook** for both 2018 & 19	**Risks** to growth outlook are to the **upside**	The current EUR level **not a concern** to the Gov Council	**QE may end abruptly** if econ recovery continues	1.25	+10 bp	+15 bp

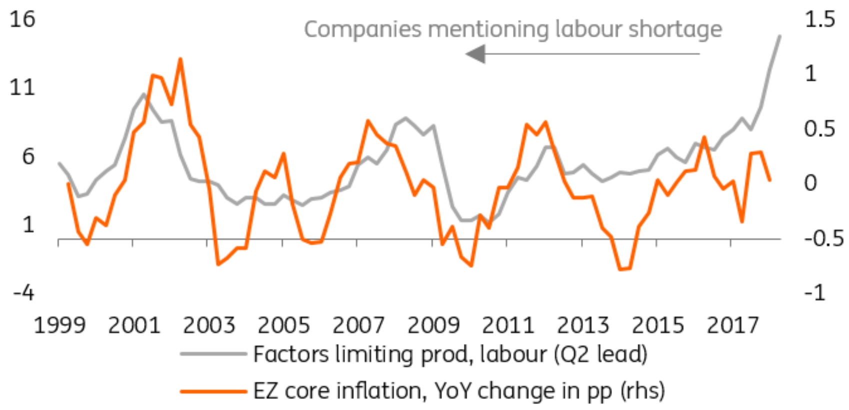
Source: ING

Taming the hawks

We expect President Draghi to convey a rather dovish message and tame the market's hawkish fantasies (at least for now). The President is likely to point at still weak inflationary pressure, emphasising the disinflationary impact from a stronger euro. Indeed, every time hawkish comments dominate the ECB debate, the euro appreciates and immediately provides ammunition for the ECB doves. **The key thing to watch:** Whether Draghi confirms the October statement that there will be no sudden end to QE.

We expect him to do so as this would be the only way – at least temporarily – to get the genie back in the bottle. It would also show Draghi's magic of how to guide financial markets with very few words and without any action. Interestingly, the ECB has picked up the narrative from Draghi's Sintra speech and is increasingly focusing on growth, considering inflation only as a derivative of growth developments.

Labour shortages and core inflation



Source: Macrobond

What this means for FX markets

High hurdle to send EUR lower

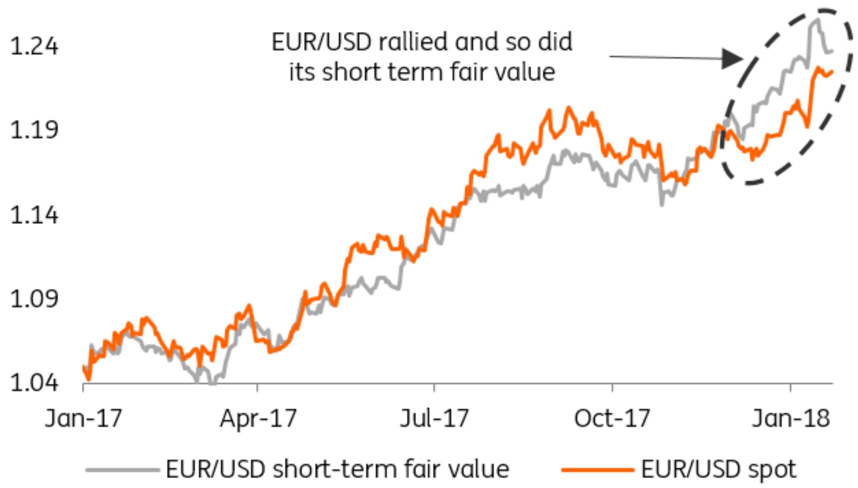
The likely cautious tone of the ECB meeting should put a limit on the scale of EUR upside rather than driving it lower. This is because

(1) even on the very short term valuation basis, the EUR/USD still remains modestly undervalued;

(2) market's base case of a cautious ECB tone, following the comments of various ECB board members;

(3) solid EZ economic outlook and the recent data upside surprises have lowered the credibility of the threat for further and material QE extension.

Euro vs. fair value



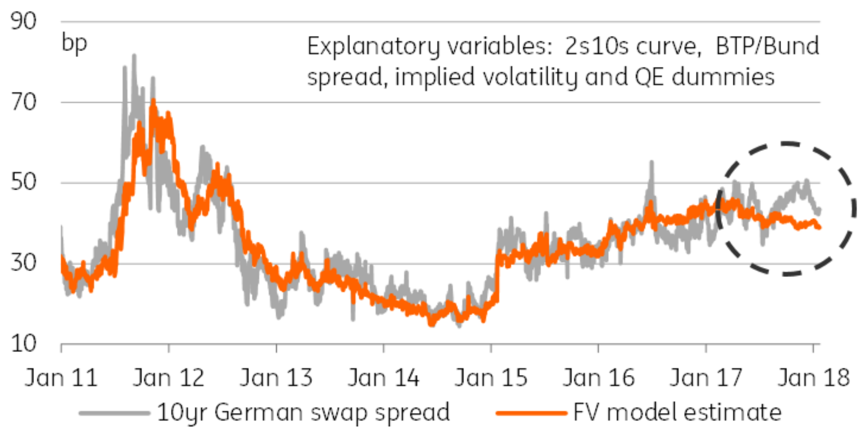
Source: ING

What this means for bond markets

Hawkish surprise less likely after recent ECB push back

Despite the recent pushback by ECB officials yields are still significantly higher than before the ECB minutes. We believe markets still await a dovish confirmation, which should prompt moderately lower Bund yields, key being the confirmation that there will be no sudden end to bond purchases. The upside in rates on any disappointment in this regard is moderated by valuation models versus swaps suggesting that Bunds are now trading less rich compared to past months.

German swap spreads vs. fair value



Source: ING

Author

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

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

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