

## ECB hawkishness not enough to lift the euro right now

The implicit openness to a 50bp hike in September by the European Central Bank today generated only a short-lived bounce in EUR/USD. We think that rising peripheral spreads and a grim growth outlook in the eurozone are keeping the euro at check, and that a return to 1.0500 remains likely

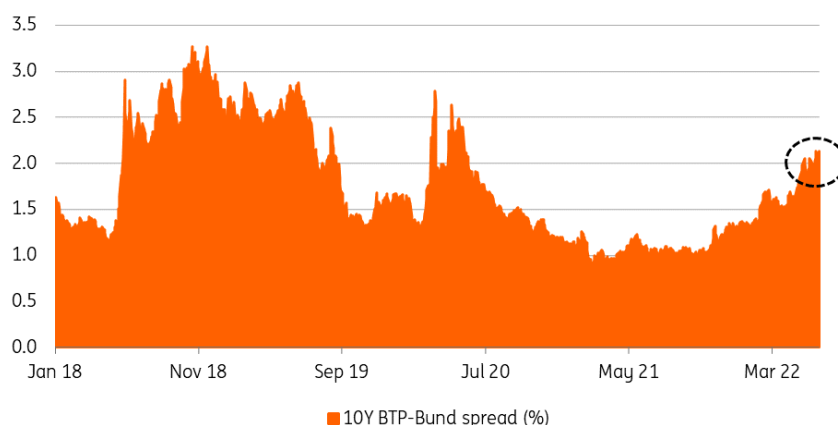


Christine Lagarde,  
president of the  
European Central Bank

The positive reaction in EUR/USD after the ECB signalled openness to a 50bp rate hike in September (while formally announcing a 25bp one in July) was exceptionally short-lived.

Probably, a key reason behind the reversal of the EUR/USD spike during President Lagarde's press conference has been the underperformance of other assets the EUR tends to be linked to in the short term. The 10-year BTP-Bund spread has widened by approximately 15bp since the announcement, and eurozone equities are underperforming US ones by around 1.20% today. Incidentally, the market's general sentiment today has leaned towards risk aversion, which is keeping most pro-cyclical pairs under some pressure.

## 10Y BTP-Bund highest since 2020



Source: Refinitiv, ING

Unsurprisingly, EUR/CHF has come under pressure (broke below 1.0400) as peripheral spreads widened. As we discussed a few weeks ago [in this article](#), the correlation between EUR/CHF and the BTP-Bund spread tends to pick up when the spread reaches levels above 200bp. Further distress in the Italian bond market can surely keep EUR/CHF upside capped in the coming quarters.

Today's price action has endorsed what our fair value model is suggesting: that equity dynamics and external risks are currently playing a bigger role in driving short-term EUR/USD moves compared to front-end rate differentials. Considering the lingering downside risks for the eurozone economy from the fall-out of the Ukraine conflict and high energy prices, a rebound in equity flows into the eurozone appears unlikely in the short term.

Should short-term rate differentials regain the role as major drivers of EUR/USD moves, the implications wouldn't necessarily be positive for EUR/USD. Markets are fully pricing in a 50bp hike in September, which is surely not a done deal, and a total of 220bp of tightening in the next year. This means that a good deal of tightening is already in the price and the room for further hawkish re-pricing is somewhat limited.

Our view remains that in the current unstable environment for global sentiment and as the Fed pushes through with 50bp rate hikes during the summer, the dollar should remain supported. As we don't see markets having a solid basis for turning substantially bullish on the euro and given the non-negligible downside risks to the eurozone's outlook, we continue to see a return to 1.0500 as the most likely scenario over the summer and into 3Q22.

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