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Snap

## Four scenarios for markets at July's ECB meeting

Draghi's challenge will be to keep markets tuned into tapering, without causing a 'taper tantrum'

### Fully justified EUR/USD strength – break above 1.1500 is on the cards

We see the two-step post-French elections EUR/USD rally as fully justified starting with a build-up of QE taper expectations, amplified by Draghi's Sintra speech, mainly driven by steeper German yield curve. It seems it will only be a matter of time before EUR/USD breaks through 1.15 (as bund yields nudge up), with an overshoot around the ECB September meeting.

### Materially lower EZ yields not necessarily desirable at this point

We see limited scope for lower Eurozone sovereign yields. While the ECB wants to avoid a taper tantrum bund sell-off, it also seeks to pre-prepare the market for eventual QE tapering via gradually higher yields. Thus, a dovish surprise and sharp decline in bund yields is not desirable. The likely retention of the QE easing bias (the threat of an increase in QE duration and size) may push German 10-year yields lower, but don't expect a material move below 0.55%. We could see German yields rise hit 0.65% later this year.

### Scenario analysis: How to position for Draghi's alternatives

	Inflation outlook	Growth outlook	Forward rate guidance	QE taper guidance	EUR/USD	Short end	Long end
	Inflation measures "continue to remain subdued"	"The risks... to growth outlook are considered to be broadly balanced"	Rates to stay "at present levels for an extended period"	QE "to run until the end of December, or beyond, if necessary"			
Dovish	Outlook for inflation has further deteriorated	Reintroduction of downside risks	Reintroduce "...at present or lower levels..."	"Need for unordinary high monetary stimulus"	1.11	-5 bp	-15 bp
<b>ING Base Case</b>	Inflationary pressures remain subdued	Distribution of risks unchanged	No change to the wording; <b>emphasise sequencing</b>	No hint at timing of the QE tapering; <b>QE easing bias kept</b>	1.14	flat	-5 bp
Modestly Hawkish	Current low inflation is <b>transitory</b>	Distribution of risks unchanged	Wording unchanged; <b>lack of sequencing talk</b>	Drop QE easing bias: threat of increase of duration, <b>NOT size</b>	1.16	+5 bp	+5 bp
Very Hawkish	"First signs of inflation pressures building up"	"Upside risks to growth outlook"	Remove " <b>present</b> ", idea of <b>sequencing scrapped</b>	ECB " <b>already looking</b> " at QE tapering options	1.18	+10 bp	+15 bp

Source: ING

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