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ECB: Avoiding taper talk - part two

After no changes to the official monetary policy decisions, all eyes were on the ECB press conference for any hints from Christine Lagarde on future tapering and any changes in the ECB's monetary policy stance. To keep it short: there were hardly any

ECB President Christine Lagarde in Brussels

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The ECB's main mission today was to avoid any taper talk and not harm the still tentative economic recovery or allow bond yields to surge prematurely.

Even if the ECB slightly resembled my dog's strategy of pretending to be invisible when a bigger dog approaches, the ECB accomplished its mission: the ECB seems to have bought some time without starting the taper talk.

Highlights from the press conference

In the absence of shocking changes in the ECB's stance and macro assessment, here is what you should remember from today's meeting:

- As regards the official decisions, today's announcement was an almost verbatim copy of the April decisions. No changes in rates, no changes in asset purchases and no changes to the language that asset purchases will be conducted "at a significantly higher pace than

during the first months of the year". Lagarde's comments during the Q&A session, however, suggested that not all ECB members supported sticking to this line.
- As regards financing conditions, Lagarde referred to increased market interest rates since March. According to Lagarde, "a sustained rise in market rates could translate into a tightening of wider financing conditions that are relevant for the entire economy. Such a tightening would be premature and would pose a risk to the ongoing economic recovery and the outlook for inflation." In our view, it is clear that the future line on higher market rates will be that increases will have to reflect improved economic prospects, otherwise the ECB will intervene.
- As regards the latest ECB staff projections, both growth and inflation forecasts were revised upwards for this year and 2022. GDP growth is now expected to come in at 4.6% in 2021, 4.7% in 2022 and 2.1% in 2023. Inflation is expected to come in at 1.9% this year, 1.5% in 2022 and 1.4% in 2023. This means that the ECB still sees the current inflation as being transitory. The reference to the slack in the eurozone economy as well as low core inflation projections support this point. More important than the pure numbers were the assessment of risks and core inflation expectations. According to the ECB, the risks surrounding the economic outlook were broadly balanced. With this, the ECB has gone through a gradual change of its risk assessment over the last months, from "risks tilted to the downside" to "medium-term risks more balanced" to now an outright "broadly balanced". At the same time, the fact core inflation is expected to come in at 1.4% in 2023, any taper in the coming months will be very soft and gradual.

Taper avoided but for how long?

The ECB is obviously buying time despite higher inflation prints and the prospects of accelerating inflation.

With hard data not yet matching the optimism reflected in strong soft indicators, the ECB would rather err to the downside than withdrawing monetary stimulus prematurely.

The ECB's strategy to avoid any taper talk simply followed the principle of the brutal force method: "we didn't discuss it", "it's premature" or "we will discuss it when the time has come". As much as we agree with the ECB that not every detail of the meeting should be shared with financial markets, it is hard to see that any central bank does not discuss future scenarios. In the end, monetary policy is supposed to be forward-looking.

Where will we go from here? Strictly taken, tapering is built into the current asset purchases as the PEPP will end in March 2022 if not extended. As soon as hard data start to catch up with strong soft indicators, confirming the view of a substantial rebound of the eurozone economy, support for asset purchases under the umbrella of pandemic-fighting will drop. The 9 September meeting could be the moment at which the ECB will at least start philosophising about tapering. However, as long as core inflation projections remain at their current low levels, tapering will rather be a rotation from one asset purchase programme to the other than a significant outright reduction of the purchases.

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