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ECB: Breadcrumbs for the hawks

The ECB dropped its easing bias on QE but subdued inflationary pressure leaves the extension of QE beyond September as our base case scenario



Bye bye easing bias

The biggest news of today's ECB press conference is the dropping of the easing bias. While the ECB reiterated that it would extend QE if necessary, it let go of the pledge to increase QE "in terms of size and/or duration" if the inflation outlook or financial conditions were to worsen. While dropping a sentence that has been in the ECB's introductory statement since 2016 is a significant change, ECB president Draghi gave his best trying to downplay exactly this significance during the press conference. Draghi stressed the fact that QE was still intended to "run until the end of September 2018, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim". Also, the forward guidance on interest rates was left unchanged and Draghi remarked that the ECB's reaction function had not changed.

2.4%

ECB estimate for GDP growth in the Eurozone this year

Up from 2.3% estimate in December

The ECB's macroeconomic assessment has not changed since the January meeting. The recovery remains strong and the expected acceleration of inflation is still much more wish than reality. On the back of the strong growth momentum in recent months, the ECB's staff projections for GDP growth were slightly revised upwards for 2018 to 2.4% (from 2.3% in the December projections) and remained unchanged for 2019 and 2020 (1.9% and 1.7% respectively). As expected, protectionism was added to the list of downside risks to the growth outlook. Or to paraphrase it: with downside risks stemming from protectionism and exchange rate volatility, the current US economic policies are regarded as the biggest risk for the Eurozone economy.

1.4%

ECB forecast for headline inflation in 2018

As regards inflation, the ECB's words still look much more promising than the actual numbers. According to Draghi, headline inflation will hover around 1.5% for the remainder of the year and underlying inflation remains low. This rather benign take on inflation is also reflected in the ECB's staff projections. According to the projections, headline inflation is expected to come in at 1.4% in 2018 and 2019 and 1.7% in 2019. Against this background, the ECB's confidence "that inflation will converge towards our inflation aim" is still much more based on wish than reality and facts. It is therefore not surprising that the ECB believes that overall, an ample degree of monetary stimulus remains necessary for underlying inflation pressures to continue to build up and support headline inflation developments over the medium term.

All options still available

It was obvious that the ECB would not and could not really react to the ongoing trade tensions as there is simply speaking very little the ECB could actually do. Only once trade tensions or exchange rate volatility pose a risk to the growth and inflation outlook, would the ECB consider reacting. Therefore, it does not come as a surprise that the ECB today changed its communication somewhat. At the same time, we would not overestimate this change. Even after dropping the easing bias, the ECB still has all options to extend QE. Beyond September 2018 but also beyond December 2018. And let's be honest, if the Eurozone economy were to suddenly enter a severe downturn, dropping the easing bias today would definitely not prevent the ECB from doing "whatever it takes". Taking all these factors together, we remain comfortable with our expectation of at least one more extension of QE, beyond September 2018.

Breadcrumbs for the hawks

Against the background of a growing divide within the ECB, today's communication change should, in our view, be seen as a conciliatory move to please both the ECB's hawks and doves. Dropping the easing bias was probably like doves feeding the hawks some breadcrumbs.

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