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ECB minutes confirm more balanced inflation assessment

The minutes of the European Central Bank's September meeting confirm a more balanced inflation assessment. In our view, the December meeting could bring somewhat more tapering than markets are currently pricing in

The just released minutes of the ECB’s September meeting, in our view, gave some interesting insights into the Bank's gradually changing inflation assessment and the discussion on the downsizing of asset purchases under the Pandemic Emergency Purchase Programme (PEPP).

Regarding the **inflation assessment,** the tone has clearly changed from a very benign approach in the summer to a more balanced view. While the ECB still favours the scenario that this year’s surge in inflation is transitory and that medium-term inflation forecasts are still far below the ECB’s 2% target, the minutes disclosed some doubts. In fact, it was acknowledged that both headline and core inflation had surprised to the upside compared with recent ECB projections and that “this raised doubts about how well the models relied on in the projections were able to capture what was currently happening in the economy, the structural changes implied by the pandemic and the impact of the ECB’s new monetary policy strategy.” There was even a mention of “possible ‘regime shifts’”.

Also, it was noted that "even if the current inflation shock was largely temporary, it would only require a relatively small percentage of the current shock to become permanent for inflation to be close to 2 per cent at the end of the projection horizon." Interestingly, the minutes shed very little light on the discussion on how and why the sentence “if supply bottlenecks last longer and feed through into higher than anticipated wage rises, price pressures could be more persistent” made it into the risk assessment of the introductory statement.

Regarding the **monthly PEPP purchases**, there had been calls for both a more substantial reduction and a more prudent reduction. Arguments in favour of a more substantial reduction were based on improved financing conditions and an improved economic outlook, while arguments in favour of a more prudent reduction were that the impression of tapering should be avoided.

What's next for the ECB?

Admittedly, monetary policy can hardly bring down inflation which is driven mainly by one-off factors. However, constantly higher inflation rates and a high risk that the ECB has actually entered a period in which its longer-term inflation forecasts frequently turn out to be too low, compared with too high in the years prior to the pandemic, will put more pressure on how much monetary accommodation the eurozone economy really needs.

Today’s minutes, as well as comments by several ECB members in recent weeks, signal a changed stance on inflation compared with a few months ago; a shift from a very benign assessment to one of more alertness and awareness that inflationary pressures might be less short-lived than initially thought. This suggests some convergence between doves and hawks at the ECB though we still expect a heated debate at the December meeting. Recent and future inflation developments are still no reason at all to discuss policy rate hikes but definitely a reason to discuss a (more significant) reduction of asset purchases and not just a recalibration.

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