

## ECB pre-preview: New complications on the road to taper

Even though we still have three more weeks to go before the next ECB meeting, recent developments clearly signal doing nothing and buying time in June is the best and most risk-free option



Source: Shutterstock

On 14 June, the ECB will hold its next monetary policy meeting.

Until now, the ECB has been very tight-lipped about the next steps for monetary policy, particularly quantitative easing (QE) beyond September this year. With a fresh update of staff projections, the ECB could have sufficient substantial input to unveil first details of the next QE steps at the June meeting or so many market participants at least say. The reality, however, could look differently. In our view, new uncertainty on the back of weaker economic data, higher oil prices and Italian politics argue in favour of buying more time.

### Three main challenges for the ECB

A quick look at the three main economic challenges the ECB will be facing at the June meeting.

#### 1 Soft patch vs downswing

At face value, the growth slowdown in the first quarter was mild enough to be filed away as a “soft patch” instead of a “downswing”. Economic fundamentals have also not changed over the last few months. However, soft indicators have not yet recovered, the fading eu(ro)phoria could dent

further optimism, and the external environment has become a risk rather than an opportunity.

The problem ECB forecasters are currently facing is that very little new hard data will become available between now and the cut-off date of the forecasts or the June meeting. In fact, except for soft indicators for May and hard data for a couple of Eurozone countries for April, no other guidance will be available. Probably too little for the ECB to take a clear position in the soft patch versus downswing discussion. Consequently, we expect the ECB to stick to its positive take on the Eurozone recovery, but at the same time stressing increased uncertainty and the need for more evidence.

## 2 The double-edged sword called oil

The surge in oil prices since the beginning of the year is probably the single biggest problem for the ECB. Since February, oil prices have increased by more than 20%. Add the effect of the weaker euro exchange rate, oil prices denominated in euro have increased by almost 30%. As so often in the past, higher oil prices are a double-edged sword for the ECB.

On the one hand, higher oil prices could dent the recovery (according to our back-of-the-envelope estimates, higher oil prices could allow one-third of the wage increases in Germany evaporate in thin air). On the other hand, they should push up the ECB's inflation projections. The ECB uses future prices as a technical assumption. If oil (and their respective future) prices were to stay at their current levels, headline inflation could come to 0.4 percentage points higher in 2019, from 1.4% in the March projections. At the same time, GDP growth forecast could be revised downwards by some 0.2 percentage points. All of this means that only due to changes in the technical assumptions, a benign outlook for headline inflation could quickly become a close-to-target forecast.

Normally, the ECB tends to look through energy-driven volatility in headline inflation and instead focus on core inflation measures as higher oil prices have a disinflationary impact on the recovery. This is why we expect the ECB to stress the reflation process will only be over once inflation has sustainably converged towards a target and that it would only react to possible second-round effects. Still, an upward revision in headline inflation could make a few hawks at the ECB and some market participants slightly uncomfortable.

## 3 Italian politics

Obviously, Italian politics is the new kid on the block when it comes to challenges for the ECB so don't expect ECB president Mario Draghi to comment on this. At best, he could give some very general remarks on how the ECB looks at the idea of mini-BoTs.

However, it seems clear that in a situation with new tensions in financial markets and speculations about a potential new euro crisis and maybe even some contagion in bond markets, the benefits of doing nothing clearly outweigh the potential costs of giving misleading hints.

### Buying time in June looks like the most risk-free option

In our view, the unconcluded debate on soft patch versus downswing, the surge in oil prices and recent political developments in Italy clearly suggest doing nothing at the June meeting is the best and most risk-free option for the ECB. The only thing Draghi could do is to reconfirm his earlier statement that he does not expect an abrupt end to QE in

September, opening the door for an extension.

The discussion behind closed doors will clearly be about how long QE should be extended for, at which amounts and whether or not an end date should be communicated, but not on the “if”. This discussion is very likely to continue until the July meeting. Then, we expect an extension of QE at a reduced amount at least until December 2018. Until then, buying time looks like the best option.

## Author

**Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.