

## ECB preview: Angry birds

The tension between a small but vocal minority of hawks and the still large majority of doves seems to be increasing. Today's ECB meeting will offer some new insights on who is currently on top in this bird fight



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For months, the macroeconomic situation faced by the ECB has hardly changed. The Eurozone is enjoying a strong recovery, which if anything has gained momentum over the last few months. At the same time, inflationary pressures remain low. For now, the expected inflation pick-up on the back of a strong cyclical recovery is more wish than reality. The latest announcement of possible trade sanctions from the US should have increased the ECB's vigilance.

### Some relief from market developments

The market rout of recent weeks should not have impacted the ECB's assessment. On the contrary, financial market developments since the January meeting should have brought some relief to the ECB. Volatility in stock markets is something that hardly interests the bank, given the small impact that these developments have on confidence in the Eurozone. It is rather the development of bond yields, oil prices and the euro exchange rate which interest the Eurozone's monetary policymakers. And in fact, oil price and exchange rate developments since December argue in favour of a slight downward revision of the inflation forecasts (was 1.4% for 2018 and 1.5% for 2019).

Despite little inflationary pressure, the end of QE is getting closer. The risk of deflation is clearly behind us and the only question is how to moderate and implement this exit. Judging from the minutes of the last two ECB meetings and regular public statements, it is clear that there is a growing divide within the ECB on how and when to exit QE.

## Watch the language

At today's meeting, we expect no hint of when QE could end but a subtle change in the ECB's language to signal that it is already en route to the exit. The broader majority in the Governing Council still seem to favour no change at all to avoid an unwarranted tightening in monetary and financial conditions, particularly now that the euro strengthening has come to a (temporary) halt.

However, even though small in number, the hawks have become more vocal. Therefore, a communication change could occur in the so-called forward guidance. According to the minutes of the last meeting, some ECB members had already called for dropping the easing bias on QE. Currently, the option for an extension or expansion of QE is linked to shocks to the economy and/or financial conditions. It is too early to drop the entire easing bias. Instead, the ECB could introduce a new concept that the full set of policy instruments would be used were the outlook for growth and inflation to worsen.

As subtle as the change in words might be, any simple change could easily revamp market speculation about a surprisingly hawkish ECB, strengthen the euro exchange rate and add to unrest in bond markets. Also, as soon as the ECB puts an end date on its QE programme, speculation about the timing of the first rate hike will start to heat up, leading to a further tightening of monetary and financial conditions in the Eurozone. Therefore, it will be a very delicate balancing act. A balancing act caused by the growing divide between a small but vocal minority of hawks and the still large majority of doves.

### Bird fight

The ECB meeting should mark another cautious and very subtle next step towards the QE exit. It will also give a good indication of who is currently on top in the ECB's in-house bird fight. ECB members, however, should not forget that when real bird fights, everybody loses some feathers.

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