ECB preview: Lots to discuss but little to talk about

This week's ECB meeting is set to prepare the grounds for the big, decision-rich, meeting in December. While there could be debate behind closed doors, the risk is high that the communication after the meeting will do more harm than good.

European Central Bank building and the Frankfurt skyline

When the ECB's Governing Council meets again this week, there will be a lot to discuss. Not only have actual inflation rates once again been higher than the ECB's own projections, higher energy prices and ongoing supply chain frictions are clearly complicating the ECB's life. While the ongoing surge in headline inflation, transitory or not, will clearly be taken as an argument for the hawks to reduce monthly asset purchases, preferably at the December meeting, the doves could argue that higher energy prices will dent private consumption and hence delay the eurozone recovery, warning against any premature withdrawal of monetary accommodation.

As regards inflation, it is not only actual inflation data which has come in higher than the ECB had expected. Higher energy prices and a euro exchange rate that is weaker than the latest macro-economic projections will also give the ECB headaches. Updating the ECB's own technical assumptions from mid-August with the new market reality would mechanically lead to another increase in the inflation projections for 2022 and 2023, by 0.1 to 0.2 percentage points, even if the increase in bond yield by some 30 basis points should have a dampening effect. Remember that, in September, the ECB's inflation projections were at 1.7% for 2022 and 1.5% for 2023.

The minutes of the September meeting had already shown that upside inflation risks were increasingly discussed. Developments over recent weeks have done nothing to temper this discussion. To be clear, this is not a discussion about hiking interest rates or introducing restrictive monetary policies. It is a discussion about whether, and how much of, the current emergency measures are still needed. Therefore, we expect a discussion on the following topics: extending the Pandemic Emergency Purchase Programme (PEPP) beyond March 2022; how to avoid a cliff edge effect and how much (if any) QE is needed in the post-pandemic era to bring inflation sustainably back to 2%? In our view, the easiest solution would be to gradually phase out the PEPP purchases starting January next year, potentially with a new third asset purchase programme to maintain the PEPP's flexibility, allowing the ECB to continue buying Greek bonds

As much course-setting this week's ECB meeting will be, we doubt that ECB president Christine Lagarde will share any important details of it. She will need all her energy to moderate what in our view looks like a widening rift between hawks and doves; of those ECB members favoring an exit from the emergency tools and those still being more afraid of medium-term inflation being too low rather than too high. Pushing the debate publicly in a certain direction would widen the rift rather than closing it. This is why, at Thursday's press conference, less (communication) should be more.

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