

## ECB preview: Lower for longer 2.0

Next week's ECB meeting should finally provide the first details of the dovish tapering plans, ideally with as little noise as possible



### Strong growth, little inflation

The state of the Eurozone economy has remained unchanged since the September meeting. Even though the results of the German elections have somewhat dampened the eu(ro)phoria of the summer months, survey indicators still point to a continuation of the recovery well into 2018. At the same time, inflation and inflation expectations remain low and clearly below the ECB's target. Like all other central banks, the ECB is probably still wondering if factors like globalisation, ageing and digitalisation can be called transitory or have they become structural issues with a permanent disinflationary pressure.

Even though inflation developments could easily argue in favour of not changing the monetary stance at all, the strong cyclical upswing together with the scarcity of bonds seems to be the primary driver for the ECB to announce first details of its tapering programme finally. Or, better describing the ECB's hesitation and caution not to scare financial markets: the recalibration of its monetary stance.

### Full agreement for once

Given official comments over the last weeks, there finally seems to be a consensus within the ECB

to at least start tapering. No single voice has been opposing this idea. However, diverging views still exist on how it should reduce its monthly QE purchases.

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*Ideally, the ECB wants to announce a dovish tapering with as little market noise as possible*

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In our view, the ECB will first identify a targeted, final, size of the balance sheet before it derives paths towards this balance sheet target. Latest newswire reports suggest the increase of the balance sheet could be between 200bn and 300bn euro. So, the big question is: how will the ECB spend it?

We think there are three potential scenarios for tapering: Fed-style tapering, the staircase option or lower for longer.

i) Fed-style, the gradual tapering option. This option would see a linear scaling back of the asset purchases. Either every month or quarter, with the latter providing more flexibility.

ii) The staircase option. Here, the ECB could reduce its monthly QE purchases in January by some 20bn euro, keep the purchases unchanged until June and then reduce the monthly purchases yet again by another 20bn euro until September.

iii) Lower for longer. Here, the ECB could reduce its monthly purchases by more than markets currently expect to about 20bn or 25bn euro per month, while at the same time extending QE until the end of 2018.

## 'Lower for longer' 2.0

Ideally, the ECB would like to announce tapering with as little noise as possible, limiting any upward movement of the euro and interest rates to an absolute minimum.

This is why we expect the ECB to announce a 'lower for longer' tapering, as in December 2016, reducing the monthly QE purchases to 25bn and extending them until the end of 2018. Also, we expect Draghi to emphasise 'sequencing', i.e. the fact that interest rates will remain low (far) beyond the end of QE which should help to anchor interest rate expectations. Such a strategy would also help to immunise the ECB's monetary policy against further exchange rate fluctuations.

### The only question is how, not if, ECB starts tapering

All in all, next week's ECB meeting should be a sea change, not a rough one but a very mild and cautious one. The ECB is still very much aware of any adverse effects from a premature tapering. Also, as strong as the Eurozone recovery currently looks, not only external risks but internal risks, think Catalonia and lack of further Eurozone reforms could easily dent the recovery.

Therefore, the ECB will do everything it can to convince everyone that its next steps are a very dovish tapering.

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