

## ECB preview: On taper auto pilot

Market volatility, Italian fiscal policies and low core inflation will do little to divert the ECB from its taper plans. The auto pilot, turned on in June, should stay on. On Thursday, the ECB will in our view deliver the first step of the pre-announced dovish tapering: a reduction of the monthly QE purchases from €30bn to €15bn



Source: ECB

*The ECB can look back on a satisfying summer break. Sure, market volatility on the back of Turkey, and recently again in Italy, has increased but fundamentally the ECB's earlier take on the economy has been confirmed. Thanks to Jean-Claude Juncker, the risk of a trade war with the US has been reduced, while at the same time confidence indicators point to stable growth in the months ahead. Only stubbornly weak core inflation could give some ECB members a hard time.*

### Risks

Almost needless to say, the risks of a trade war and Italian (fiscal) politics harming Eurozone sentiment have not disappeared and could easily gain traction in the coming months. However, it

would need a severe new euro crisis for the ECB not to bring QE to an end. In this regards, Italian calls on the ECB to extend QE beyond December this year should meet with deaf ears.

## Macro to the forefront

At next week's meeting, macro developments and the next round of ECB staff projections should dominate the discussion. This time around, there should be very little impact from changes in the technical assumptions. After some fluctuations over the summer, oil prices and the exchange rate have returned to their levels of late-May, the cut-off period for the ECB's June projections. If anything, the weaker euro could lead to a very minor upward revision of both GDP growth and headline inflation.

Overall, however, the ECB's macro projections will be mainly determined by the underlying view on the economy and not so much by the external environment. In this regards, any revisions to the GDP growth and inflation forecasts for 2019 and 2020 could clearly have implications for the future path of the ECB's monetary policy. Our eyes will particularly be on the ECB's core inflation forecast, which up to now has been subject to extreme optimism about a return from currently 1% to 1.9% by 2020 (on average).

## Policy action

Thanks to the June announcement of an anticipated reduction of the monthly QE purchases to €15bn after September, and an end of the net purchases by the end of the year, the European Central Bank has put itself on auto pilot. In fact, as long as there are no real accidents in the economy or inflation developments, the ECB can lean back, relax and simply continue to deliver on the dovish tapering. The first delivery should be next week as there is very little reason to doubt that the ECB will announce the reduction of the monthly QE purchases from €30bn to €15bn. For the rest, there is no need to think about tweaks to its communication. The ECB will only have to repeat its anticipation to put an end to QE by year-end.

## Outlook

Even though wage increases in several countries have still not found their way into higher core inflation and trade tensions, or Italian fiscal policies bear the risk of increasing uncertainty, the underlying solidity of the Eurozone recovery should comfort the ECB to stay on auto pilot. With the end of the net purchases of the QE programme in sight, market focus will shift to the length of reinvestments and obviously the timing of the first rate hike. Here, ECB President Mario Draghi was very clear: interest rates will remain unchanged at least through the summer of 2019. This would give him two opportunities to hike rates before he leaves office: in early September and late October. In our view, he will use at least one.

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