

17 January 2018  
Article

## ECB preview: Taming the hawks

Recent euro strengthening should help Mario Draghi tame hawkish fantasies at next week's ECB meeting

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At the start of the New Year, the ECB could currently feel as if it was in the middle of the set of a movie combining the scripts of “Groundhog Day” and “Aladdin”. Every time the ECB thinks that it bought some time and quiet, either macro developments or some ECB members' statements (or sometimes both) undermine these plans and let the genie of speculations about policy changes out of the bottle. While the ECB had actually tried to hush any exit speculation with the October decision for “lower for longer”, strong macro data, a general fear in financial markets that inflation is not dead and could return faster than anticipated as well as some ECB officials' talks have recently again fueled new speculation about the future of QE.

### Don't get carried away by hawkish comments

The always-returning speculation on whether the ECB could stop QE in September was not only fueled by recent statements by Bundesbank President Weidmann and ECB Executive Board member Coeuré but also by the minutes of the ECB's December meeting. In fact, the strong economic upswing combined with a series of indicators pointing to the possibility of increasing inflation seem to build the case against an extension of QE beyond September. However, there are at least three reasons why we expect Mario Draghi to resist the hawkish sirens:

- Structural factors are keeping inflation low. The minutes of the December meeting showed that the ECB itself still has doubts that strong growth really translates into higher inflation. It should but structural factors like globalisation, digitalisation and labour market slack could distort textbook relationships between growth and inflation. Also, the German experience of a very mature cycle providing very little wage inflation gives reasons to be cautious. In this regards, the ECB is clearly having a close eye on the ongoing wage negotiations in Germany.
- The catch 22 argument. Every time, hawkish comments dominate the ECB debate, the euro appreciates and immediately provides ammunition for the ECB doves. Even though the ECB thinks that a stronger euro has a smaller negative impact on growth than in the past, they are definitely concerned about the impact on inflation. From a pure technical perspective, the latest strengthening of the euro (if sustained) would lower the ECB's inflation assumptions for 2018 and 2019 by some 0.2 percentage points, making the case for an early end to QE less compelling.
- The read-my-lips argument. The biggest argument against an early end to QE are Mario Draghi's words. Back in October, Draghi said that “it's never been our view that things should stop suddenly”. A strong statement. However, Draghi made this statement during the Q&A session, it was not part of the introductory statement, and might not have been the agreed

wording of the entire Governing Council.

## Another 'lower for longer' beyond September remains our base case

We stick to our previous view that the ECB will not stop QE in September but will rather decide on another “lower for longer” beyond September, probably until the end of the year. Given that even the hawks are currently emphasising sequencing, a first rate hike will not be on the cards before mid-2019. Interestingly, the ECB has picked up the narrative from Draghi’s Sintra speech and is more and more focusing on growth, considering inflation only as a derivative of growth developments.

### Draghi's magic

For next week’s meeting, we expect Draghi to convey a rather dovish message, pointing to still weak inflationary pressure and also emphasizing the disinflationary impact from a stronger euro. The most important message to watch will be whether Draghi confirms the October statement that there will be no sudden end to QE. We expect him to do so as this would be the only way to – at least – temporarily get the genie back in the bottle. It would also show Draghi’s magic of how to guide financial markets with very few words and without any action.

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