

## ECB preview: The breather meeting

Next week's meeting should tell more about Christine Lagarde's communication skills than about the future path of monetary policy



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They have deserved it. After all the excitement since March, next week's meeting should give the ECB some time to reflect and take stock. It will not be the moment to decide on any new action.

The June meeting had not only delivered an increase in the size of the Pandemic Emergency Purchase Programme (PEPP) but also addressed the German Constitutional Court's ruling on the Public Sector Purchase Programme (PSPP) and paved the way for a workaround. By now, the minutes of the meeting and the German parliament's assessment should have eased the tension and reduced the tail risk of the Bundesbank eventually having to step out of the PSPP. The ECB can again concentrate on fighting the economic impact from Covid-19.

Overall, there is too little new data evidence to change the base case. If anything, the ECB is also witnessing a rebound in economic activity in the eurozone, driven by the lifting of the lockdown measures. Also, the ECB will have closely followed latest German data, showing that external demand and industrial production is lagging behind domestic consumption. The exact size of the economic impact in the second quarter will only become clear towards the end of the month with the first estimates for GDP growth. Currently, there is an interesting discrepancy between more real-time and experimental GDP growth trackers and more conventional forecasts.

## *The real test case will come in the second half of the year.*

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The latter being more optimistic than the former. In any case, in our view, the real test case will come in the second half of the year. June data should still be positive, continuing the – at least initial – V-shaped recovery. Therefore, July data will in our view be key for the future path of monetary policy.

The inflation outlook has also hardly changed since the June meeting. Despite some inflationary pressure in some pockets of the economy due to some price mark-ups, the overall picture with high unemployment, increased uncertainty and the risk of companies going out of business is clearly disinflationary.

Looking beyond next week's meeting, there is the ongoing question on whether to once again increase the size of the PEPP or maybe even to end the programme earlier than expected. The ECB has always emphasized the flexibility of the programme and the fact the eurozone bond yields are back at pre-crisis levels as well as some slowing of the pace of the ECB purchases has given rise to speculation in markets about a possible earlier end. In our view, this speculation is premature. The economic outlook for the eurozone is simply too uncertain. Also, the negotiations (and eventual decision) on the European Recovery Fund will also have an impact on bond yields. An agreement next week should stabilize bond yields. Disagreement and postponement could add new pressure on peripheral yields.

All in all, the next important stop for the ECB will be the September and October meetings. This is when there will be clear information and evidence on the shape of the recovery going into the second half of the year. Next week's meeting will rather be a test for ECB President Christine Lagarde's communication skills. What will she tell if there is actually nothing to say?

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