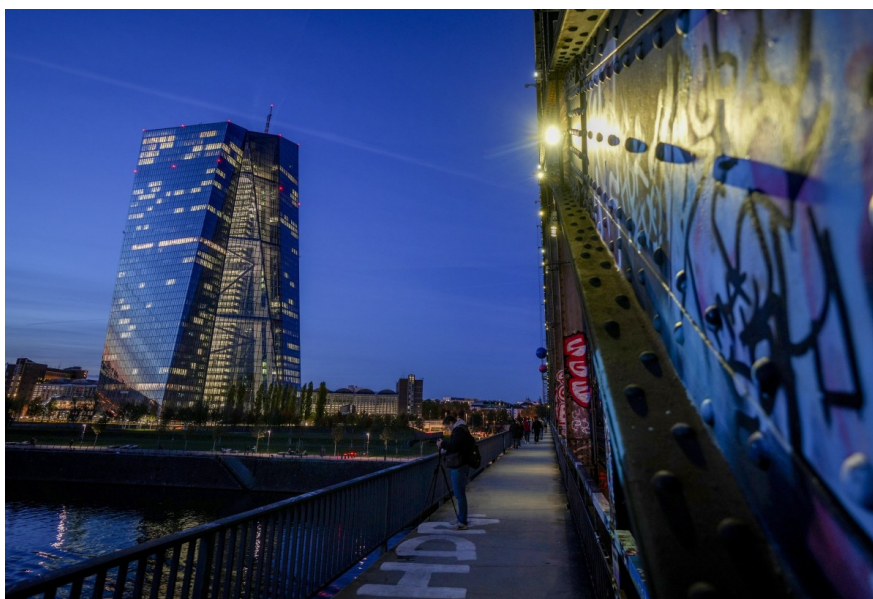


## ECB slowly joins the tapering bandwagon

With inflation being notoriously higher than the European Central Bank's own forecasts, the risk of being behind the curve has increased, triggering the beginning of tapering soon



European Central Bank, Frankfurt, Germany

Source: Shutterstock

It took a while but the ECB finally shifted its official communication on inflation from the broad denial of the summer months towards a much more balanced assessment and a good in-depth analysis of the factors currently driving inflation. Even though the ECB admitted that its previous forecast on when inflation would come down again, had been too optimistic, the overall view that the current inflation spur is temporary remains in place. 'Temporary' or 'transitory' has just become a bit longer. However, the risk remains that as much as the ECB frequently overestimated inflation dynamics during the last decade, it could now structurally underestimate inflation.

In our view, the ECB will not quickly change the new more balanced assessment of inflation. Even if energy prices were to stay high or move even higher, the definition of 'transitory' could be stretched out even further. This means that it would require a sharp acceleration in underlying inflation or services inflation, to start another rethink at the ECB. In this regard, wage developments will be key. However, similar to the Federal Reserve's approach, we expect the ECB to tolerate at least one bout of second-round effects on wages, labelling them as welcome

compensation for the 2020 drop in real disposable incomes.

---

*As long as the ECB sees higher inflation as being transitory, there won't be any drastic change in monetary policy*

---

As long as the ECB sees higher inflation as being transitory, there won't be any drastic change in monetary policy. Indeed, there is very little the ECB can actively do to stop the current inflation surge. No one can seriously believe that ECB action will move containers faster from Asia to Europe or increase global oil and microchip production. To some extent, an inflationary supply shock is actually deflationary. However, the current economic backdrop of a still improving economy and too high actual inflation, increasingly argues in favour of withdrawing some monetary policy stimulus.

The ECB's previous assessment that the costs of being behind the curve are smaller than the costs of premature tightening, might need a rethink. The ECB does not really want to end up in a situation in which it has to admit that it was wrong on inflation being transitory and then having to react swiftly and with full force, potentially causing a recession. Consequently, we expect the ECB to make a clear distinction between reducing and stopping the current emergency measures on the one hand, and actively hiking interest rates on the other. It will be like taking the foot off the accelerator gradually but not hitting the brakes.

## What we expect the ECB to decide in the coming months

In our view, the following will happen at the December meeting and in the months after:

- The Pandemic Emergency Purchase Programme will be gradually reduced starting in January 2022 and brought to an end in March;
- A new asset purchase programme (call it the Pandemic Transition Purchase Programme) will be introduced to deal with the 'cliff edge' effect and to maintain the flexibility of PEPP (mainly to continue purchasing Greek bonds). This programme will have an envelope of around €300b and will last at least until 3Q 2022. Alternatively, the ECB might decide to make the 'old' asset purchase programme (APP) more flexible and tackle the cliff edge problem only with this;
- The 'old' asset purchase programme will continue to run at €20b per month and at least until 2Q 2023;
- The favourable conditions of the Targeted Longer-Term Refinancing Operations (TLTRO) will not be extended beyond the end of this year. If TLTROs are stopped entirely, the current tiering system could become more favourable for banks;
- Against all of the above, a first rate hike will not be on the cards before the second half of 2023.

All of this means that the ECB is slowly joining the central bank bandwagon of tapering, even if it is in no rush to actually tighten monetary policy.

## Author

### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.