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ECB: Auto pilot confirmed

The minutes of the ECB's September meeting underline the Governing Council is very comfortable with the autopilot of a gradual quantitative easing tapering

Source: Andrej Klizan

Three main take-aways from the minutes

The just-released minutes of the European Central Bank's September meeting give a good grasp of the discussion behind closed doors. Remember that the ECB had announced the expected and so-called anticipated reduction of monthly quantitative easing (QE) purchases from 30 billion euro to 15 billion euro, starting 1 October.

For the rest, the forward guidance on an end of net asset purchases (end of this year) and interest rates (unchanged at least through the summer of 2019) had remained unchanged.

In the minutes, the following three issues stood out:

- During the meeting, there had been an extensive discussion on the growth outlook and the potential impact from trade and emerging markets. As already illustrated by ECB president Mario Draghi's comments at the press conference after the September meeting, the ECB had become a bit more cautious about potential risks to what is still regarded as a solid recovery. One member of the Governing Council even remarked that due to trade tensions

and global risks, risks to activity could be characterised as being tilted to the downside.
- The other important issue was the discussion on core inflation. Here, the ongoing discrepancy between low actual numbers and the ECB's expectation of a pick-up still remain. It is obvious that the ECB still believes that supply-side constraints should translate into higher core inflation. However, the discussion also stressed that evidence of this materialising is still very scarce. There also seems to be some doubt within the ECB on whether higher wages would actually lead to higher inflation as an increase in labour productivity could mitigate any inflationary effect.
- Finally, the word "vigorous" was missing in the minutes. Two weeks ago, Draghi's comments at European Parliament about a "relatively vigorous" pick-up in underlying inflation in the coming years led to some excitement in financial markets. The fact that this wording is not in the minutes, as well as the fact that the ECB staff had actually lowered its core inflation projections for 2019 and 2020 at the September meeting, are in our view reason enough to believe that "vigorous" was one of the very rare slips of the tongue by the ECB president.

Little reason to doubt the ECB's auto pilot

Still, financial market participants keep on speculating about the timing of a first rate hike by the ECB. Every time, headline inflation picks up, or a hawkish member of the Governing Council makes a slightly misleading statement, market participants seem to get nervous.

But, in our view, there is very little reason to doubt the ECB's autopilot. The communication and the forward-guidance of the ECB since June has been very consistent and straightforward. The essence of the ECB's strategy is a gradual end of the net asset purchases of QE by the end of the year and possibly a first rate in September or October next year.

The only unanswered questions are for how long the ECB would be willing to continue reinvesting maturing assets, whether the ECB would first hike the deposit rate and then the refi rate or both together and what the size of the rate hike will be.

However, it is currently far too early to answer these questions. Why should the ECB unnecessarily commit itself? As illustrated by the current market turmoil and doubts about the strength of the global economy, too much can happen between now and the end of summer 2019.

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