

ECB finally checks in with reality

At today's meeting the ECB finally caught up with reality, at least a little bit, by adjusting the size of asset purchases to what the ECB had already done over the summer and, more importantly, finally giving in on the full benign neglect of inflationary pressures



President of the European Central Bank (ECB) Christine Lagarde

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The only tangible change at today's ECB meeting was an end to the front-loading of asset purchases under the Pandemic Emergency Purchase Programme or, as ECB President Christine Lagarde called it, 'a recalibration'. Instead of the 'significantly higher pace' of purchases than at the start of the year, the ECB will now conduct the purchases at 'a moderately lower pace than in the previous two quarters'. As latest figures had shown that the ECB had already bought less (around 65bn euro) in recent months, today's announcement is probably more about catching up with reality than any sign of coming tapering. What a 'moderately lower pace' will actually mean in practice remains unclear. We expect the ECB to continue purchasing between 60bn to 70bn euro per month until the end of the year.

Highlights from the press conference

The press conference today brought, in our view, interesting insights; namely a very subtle but clear shift from the ECB on inflation. In our view, they are preparing the ground for a grand

recalibration between the PEPP and Asset Purchase Programme next year.

The ECB's growth projections did not deliver any big changes. On the back of a stronger second quarter number, the ECB revised upwards GDP growth for this year to 5%, from 4.6% in June. For 2022 and 2023, the ECB expects eurozone GDP growth to come in at 4.6% and 2.1%.

Regarding inflation, the ECB expects headline inflation to come in at 2.2% in 2021, 1.7% in 2022 and 1.5% in 2023, from 1.9%, 1.5% and 1.4%, respectively. An upward revision across the board.

The upward revision to the ECB's inflation projections over the entire forecast horizon illustrates that the Bank has started to think differently about inflation. While Lagarde first stressed that higher inflation was still mainly temporary and transitory, she concluded that underlying inflation pressures had edged up. Moreover, contrary to the July meeting, Lagarde pointed out that price pressure could be more persistent than previously thought. It made its way into the official risk assessment, while in July the risk assessment only related to growth. This is in our view a very important change in the ECB's (official) stance on inflation. While the ECB's take on inflation had been one of almost full denial, the Bank finally seems to have woken up to the reality that its models might not entirely capture the pass-through of higher producer prices on consumer prices and higher headline inflation on wages in the unprecedented situation of a (global) economy coming out of lockdown. That said, with a 1.5% core inflation forecast for 2023, the ECB is sticking to its view that the risk of inflation being too low is clearly higher than being too high.

What's also new in the ECB's communication is that asset purchases are no longer only conditional on financing conditions and in turn their impact on inflation but now equally important in both financing conditions and the ECB's inflation outlook.

Where will the ECB go from here? Watch the December meeting

Tapering in the eurozone will definitely look differently from tapering in the US. As with so many things, it will be more complicated in the eurozone. Judging from today's decisions, any hints on tapering should not be looked for in the PEPP but rather in the ECB's plan for the APP. The ECB does not deem it necessary to extend the PEPP beyond the planned March 2022, given that the ECB expects the eurozone economy to have returned to its pre-crisis level by the end of this year. The long-awaited acknowledgement of potentially higher inflationary pressure also implies that the PEPP will not be extended but that the APP will be increased. The moment to announce details of the rotation out of PEPP and into APP will be the December meeting. At that meeting, a possible decision on the Targeted Longer-Term Refinancing Operations will also be taken. The rotation will not be an unwinding of all asset purchases as potentially seen in the US. Instead, any tapering in the eurozone will likely follow a stop-and-go approach and could last well into 2023; unless the ECB changes its take on inflation even further in the coming months.

All in all, today's meeting can be best summarised as the ECB finally catching up with reality, on asset purchases and more importantly on inflation. ECB watchers can take a break in October. It's the December meeting which will be the mother of all ECB meetings.

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