

ECB: Looking through inflation (and platitudes)

A front-loading of asset purchases and a very nebulous reaction function. This is not only the European Central Bank's answer to higher bond yields but probably also the outcome of a controversial discussion at the ECB's Governing Council



How will the ECB react to the recent increase in inflation and bond yields? This was the main question ahead of today's ECB meeting. The announced decision to front-load asset purchases in the coming months and the press conference with ECB President Christine Lagarde suggest that the ECB is split on how to continue.

Fresh round of macro projections

In its broader general macro assessment, the ECB has not really changed its mind. Despite delays in the vaccination rollout and longer-than-expected lockdowns, the ECB's GDP growth forecasts remained almost unchanged from December, with the ECB now expecting GDP growth to come in at 4% in 2021, 4.1% in 2022 and 2.1% in 2023. The ECB remains optimistic that fiscal policy support and the reopening of economies will lead to a significant pick-up in the course of this year.

Remarkably, the ECB changed its risk assessment from 'tilted to the downside but less pronounced' to 'more balanced'.

As regards inflation, the ECB seems to have updated its oil price assumption and actual inflation data for January and February but is not expecting an uncontrollable acceleration in inflation. At 1.5% for 2021, 1.2% in 2022 and 1.4% in 2023, the ECB sees just temporary and one-off factors driving inflation. According to Lagarde's comments during the press conference, the ECB will look through any temporary acceleration in prices. She also stressed the high level of slack in the eurozone economy which would prevent any wage pressures from emerging.

Explaining the ECB's reaction function

With the latest increase in bond yields, financial market participants had expected the ECB to better clarify its current reaction function. The decision to front-load its asset purchases over the next quarter took away some of the pressure, indicating that the ECB was willing to put a cap on yields. The comments during the press conference, however, were more confusing rather than providing any clarity.

What is clear is that the ECB will continue focusing on 'preserving favourable financing conditions'; no yield curve control as Lagarde stated during the press conference. According to the ECB, 'financing conditions are defined by a "holistic" and "multifaceted" set of indicators, spanning the entire transmission chain of monetary policy from risk-free interest rates and sovereign yields to corporate bond yields and bank credit conditions. The comments during the press conference, however, added confusion and no additional clarity. Holistic, multifaceted, upstream, downstream, anchor and compass. A series of platitudes my editor would not allow me to use; at least not this prolifically.

Three key takeaways

What to make of this festival of platitudes? Let's take a step back, forget the platitudes and just look at the facts. There are, in our view, three main takeaways from today's ECB meeting: i) the ECB will look through any temporary acceleration of inflation and expects inflation to slow down again next year; ii) the ECB will front-load asset purchases in the coming months to underline its willingness to look through higher inflation and limit further bond yield increases; iii) the change of the balance of risk for the economic outlook suggests that any increase in the total size of the asset purchases is still far out and unlikely. Instead, today's decision looks like a compromise of a split Governing Council.

Author

Carsten Brzeski

Global Head of Macro

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 www.ing.com.