ECB meeting: It's not Autumn yet

No policy action today but an announcement by ECB President, Mario Draghi, that the October meeting will provide most details on the ECB's game plan for tapering

Source: Andrej Klizan

Act 2

The second act of today's ECB craze was clearly more exciting than the first. While the earlier policy announcement and the introductory statement were almost as exciting as the drowsy music on the ECB's live stream ahead of the meeting, the Q&A session almost had the explosive power of a good Nirvana song. In short, ECB president Draghi announced that at the October meeting, the ECB will present a bulk of measures to "calibrate" its QE program.

> *There were no real surprises on how the ECB looks at the Eurozone economy.*

Briefly on the ECB's macro assessment: The recovery is still strong, even though the ECB seems to see some levelling off as the economic expansion is no longer considered as "strengthening" but "continuing". That growth is currently not a concern is also reflected in the latest ECB staff projections which see GDP growth at 2.2% in 2017, 1.8% in 2018 and 1.7% in 2019. Risks to the growth outlook were still balanced, but the ECB explicitly mentions the exchange rate as a downside risk.

The fact that the stronger euro has become a concern was also reflected by a new sentence in the introductory statement, namely "t*he recent volatility in the exchange rate represents a source of uncertainty which requires monitoring with regard to its possible implications for the medium-term outlook for price stability".* However, despite the strong euro appreciation since the last forecasts, ECB staff only slightly revised their inflation projections downwards. This suggests that underlying inflationary pressure is somewhat higher than expected and that, up to now, stronger growth has partly offset adverse impacts from a stronger euro. With 1.5% in 2017, 1.2% in 2018 and 1.5% in 2019, however, the ECB would still miss its own inflation target for another two years.

Excitement builds

The most exciting part of today's ECB meeting came at the start of the Q&A session. In the good old manner of former President, Jean-Claude Trichet, Mario Draghi used the first question by journalists not to answer the question, but to answer an unasked question and deliver the ECB's main policy message. This main policy message had several elements:

1. The next meeting in October will be used to "calibrate" QE beyond the end of 2017
2. Most ECB members see the stronger euro as a concern, which requires close monitoring
3. The relevant committees had already been in action and were tasked to conduct further work on different tapering scenarios
4. Various scenarios on how QE could be adjusted in terms of size and length were already discussed today
5. Changes to the issuer limits were not discussed
6. The emphasis on the strong recovery means that the ECB prepares a narrative in which tapering is the removal of stimulus but not tightening
7. No changes to the sequencing had been discussed by the ECB

All of this did little to calm the FX market as the euro exchange rate breached the 1.20 EUR/USD level during the news conference, the reason probably being that the ECB's real game plan is still unclear. What in our view, though, is clear is that the ECB is not so much concerned about the past appreciation of the euro but rather on its future appreciation. However, given that Draghi repeatedly mentioned the forward guidance on interest rates, favourable financing (not financial) conditions and stressed that sequencing had not been discussed, it seems as if the ECB is willing to somewhat tolerate a further strengthening of the euro so long as interest rates across the entire spectrum remain low.

In sum, even though the ECB failed to present details of a game plan, the ECB's intentions are clear: prepare a very smooth tapering without pushing up interest rates and with as little further euro appreciation as possible. In our view, this could mean a somewhat softer tapering than we initially thought, announcing at the October meeting a reduction of the monthly purchases to no less than 40bn euro starting in January. Whether the ECB will succeed will only be known after the Third Act in October. Until then speculation will continue as market participants will probably not live up to an old song by Green Day. "*Wake me up when September ends".*

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