

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 “*the 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*”.

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 <http://www.ing.com>.