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ECB's Schnabel calls inflation risks "skewed to the upside"

If a member of the ECB's Executive Board calls inflation risks "skewed to the upside", this is a clear signal that the gradual exit from ultra loose monetary policy is about to start.

Isabel Schnabel

ECB Executive Board member Isabel Schnabel is not a stereotypical German monetary policy hawk but rather someone with a very balanced and open view. Therefore, her comments at a just released interview with Bloomberg are not only remarkable but also important in the run-up to the 16 December ECB policy meeting. Schnabel did say that "risks to inflation are skewed to the upside" but also made the point that there could be "certain structural factors" pushing up energy price inflation in the coming years; the most notable being the green transition.

A sentence like "the risks to inflation are skewed to the upside" is remarkable. Remember that in the very distant past, the ECB not only had a risk assessment on the economic outlook but also on the inflation outlook. In this context, phrases like "risks are tilted to the downside or upside" were applied and also used as a first signal to market participants on possible next steps for the ECB. The last time the ECB had such a risk assessment on inflation was in 2014!

The Schnabel interview contains further very interesting insights and confirms our own view of what will be next for the ECB. In short, Isabel Schnabel showed that she is content with the fact that markets no longer price in a rate hike for 2022, stressed her known view that going forward it was the stock of asset purchases rather than the monthly flow which contributed most to the ECB's accommodative monetary stance, that asset purchases beyond the Pandemic Emergency Programme (PEPP) should still provide flexibility, and that a decision on whether or not to extend TLTROs into 2022 was not necessarily needed at the December meeting.

Isabel Schnabel's interview gives, in our view, clear hints at how the ECB will try to cautiously join the exit lane. The fourth Covid wave and further lockdowns in the eurozone have clearly complicated things for the ECB. It is not impossible that at the 16 December meeting the fourth wave will be at its peak, with more eurozone countries back in lockdown. Such a scenario could increase the temptation for some ECB members to argue for an extension of the PEPP beyond March 2022, particularly as the 'P' stands for pandemic. However, extending PEPP could run the risk that by Spring next year the ECB will find it even harder to withdraw stimulus - by then the fourth wave should be over, supply chain frictions should have started to abate and growth should have returned forcefully. In any case, the ECB will need to address the issue that PEPP offers much more flexibility than purchases under the old asset purchase programme (APP). Consequently, the ECB will have to find a way to ensure this flexibility while ending PEPP and leaning solely on APP. One option could be to extend PEPP by one quarter, another could be to introduce a new transition purchase programme, and a final one could be to change the terms of APP.

The ECB meeting on 16 December is still some way out but the discussion at the ECB has clearly started. We expect the ECB to end PEPP in March 2022, introduce a new third transition purchase programme and to gradually move over to APP as the only asset purchase programme. The ECB will try everything it can not to call this tapering but rather recalibration as will not announce an end to its asset purchases (yet). We agree with Isabel Schnabel that, in the medium term, new structural factors have gradually pushed inflation risks to the upside - discussions on a first rate hike should start gaining momentum towards the end of 2022.

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