The ECB wants to keep all options open

The minutes of the ECB's October meeting didn’t contain any big surprises, though it's worth mentioning that it now takes into account the possibility of higher medium-term inflation, necessitating "sufficient optionality in the calibration of its monetary policy measures"

European Central Bank building and the Frankfurt skyline

Growth downgrade for 2021, upgrade for 2022

In the past few weeks, a number of speeches and interviews by European Central Bank Board Members, notably the intervention of Isabel Schnable, already showed that the ECB was having doubts on their inflation forecast that it would fall back to below 2% over the forecasting horizon. Today’s published minutes of the October meeting showed that the inflation views have been somewhat upgraded, though there is still much uncertainty.

The Council maintained its views on a still solid but somewhat slowing recovery. The supply chain distortions currently hampering production would, according to the Council, probably lead to a downward revision of 2021 GDP growth estimates in the December Staff projections, but at the same time push 2022 growth forecasts upwards.

Inflation higher than expected

On inflation, a great number of points were raised. There was consensus that inflation had been systematically underestimated lately and that the short term forecasts had to be revised upwards in the December staff projections. In the medium-term inflation outlook, there was a lot more uncertainty. It's interesting to note that the ECB now takes into account the fact that energy prices might remain a bit higher on the back of the 'green transition'. At the same time, the Council thinks that a sustainable upward shift in inflation requires higher wage growth and inflation expectations. As there is still some slack in the labour market, that could still take some time to materialise.

Taking into account different inflation scenarios

The fact that medium-term financial market inflation expectations are now at 2% didn't bother the Council as some of the increase was also due to a higher risk premium. On top of that, the ECB welcomes the re-anchoring of inflation expectations at its 2% target. In that regard, the ECB didn't see the necessity to significantly alter its communication. However, an increase in the upside risks to inflation had to be acknowledged. It was therefore seen as important that the Governing Council should keep sufficient optionality to allow for future monetary policy actions, including beyond its December meeting. Finally, there was agreement that net purchases under the PEPP could be expected to come to an end by March 2022, in line with the date that the Governing Council had announced in its previous communication.

With Covid-19 infections rising again and partial lockdown measures likely leading to a near term soft patch in the recovery, the ECB's December meeting will still be surrounded by a lot of uncertainty. While some tapering of bond purchases still looks a done deal for 2022, the ECB is now more likely to keep its cards close to its chest regarding its policy beyond the pandemic related weakness.

Author

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com