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ECB: TIPTOEING TOWARDS THE EXIT

Berenberg Macro Flash

Another baby step. Praising the firming economic recovery and upgrading the assessment of risks to growth from “tilted to the downside” back to “broadly balanced”, the ECB today dropped its rate cut bias while keeping interest rates unchanged and maintaining its dovish guidance on its ongoing asset purchases. We look for the ECB to take the next step in September, announcing that it will gradually scale back its asset purchases from January 2018 onwards.

Not too hot, not too cold: the economic backdrop for the ECB is encouraging. Upon raising its growth forecasts today, the ECB also lowered its inflation projections. Thanks partly to broadly successful ECB policies, the Eurozone is living in Goldilocks’ land for the foreseeable future.

For the first time since August 2011, just before President Draghi took office, the ECB stressed that risks to growth were “broadly balanced”. The ECB is in a comfortable position that it can prepare markets, households and companies very gradually for the coming removal of policy stimulus. Meeting in Tallin this time, the ECB was right to follow the Estonian proverb of “kes kannatab, see kaua elab” (“he who is patient will live long”). That the dispersion of growth and inflation across countries is also low by historical standards, makes the life for the ECB even easier pursuing its single monetary policy for the 19 members of the currency union.

By dropping the easing bias on rates, the ECB acknowledged that the – overhyped – deflation risks which the ECB had seen last year have dissipated. As a firming labour market underpins a solid economic recovery, core inflation will probably edge up gradually in coming years.

The ECB maintained its guidance on the sequence of future policy steps, stressing that rates would be raised only “well past the horizon of the net asset purchases”. Asked in the press conference whether tapering might become a possibility in September, Draghi responded this ‘wasn’t discussed’. President Draghi said it was important to keep in mind the “flat and low profile of underlying inflation.” Draghi’s provided three mantras regarding policy normalisation: “We need to be patient, we need to be confident, we need to be persistent.” Draghi explained that the low growth rate of core inflation was mostly due to subdued wage growth because of structural changes in the labour and job creation occurring mainly in the low-productivity sector.

ECB PROJECTIONS: GROWTH UP, INFLATION DOWN = POLICY UNCHANGED

The ECB raised its **growth** forecasts marginally, from 1.8% to 1.9% in 2017, from 1.7% to 1.8% in 2018 and from 1.6% to 1.7% in 2019. This is slightly above our own forecasts of 1.8% and 1.7% in 2017 and 2018. Since the ECB published its last staff projections in March, most economic data have, on balance, exceeded expectations slightly. Inflation, however, surprised on the downside this year so far owing mainly to lower-than-earlier-expected energy prices. The ECB thus cut its **inflation** forecasts, from 1.7% to 1.5% in 2017 (in line with our forecast) and from 1.6% to 1.3% in 2018 (well below our forecast of 1.6%). Interestingly, the ECB also lowered its inflation forecast for 2019, from 1.7% to 1.6%, which is the year in which monetary policy decision taken now could be expected to show their full impact. Underlying price pressures have remained as subdued as they have been earlier this year and sticky at around the rate its has been for over the last three years (0.9%).

Forecasts for Eurozone Inflation	2017	2018	2019
ECB (June projections)	1.5	1.3	1.6
ECB (March projections)	1.7	1.6	1.7
Bloomberg consensus	1.6	1.5	1.7
Berenberg	1.5	1.6	

Yoy change in %. Source: ECB, Bloomberg, Berenberg

Forecasts for Eurozone real GDP	2017	2018	2019
ECB (June projections)	1.9	1.8	1.7
ECB (March projections)	1.8	1.7	1.6
Bloomberg consensus	1.7	1.6	1.4
Berenberg	1.8	1.7	

Yoy change in %. Source: ECB, Bloomberg, Berenberg

ECB OUTLOOK

In their impact on the suitable stance of monetary policy, the revisions to the GDP and inflation projections largely offset each other. The ECB can thus stay on the course on having to withdraw their monetary accommodation only very slowly and adjusting its guidance and policies in small steps:

- We look for the ECB to use its new set of economic projections in September to confirm that it will start to scale back its asset purchases in January 2018 followed by further reductions until the purchases end in the autumn of 2018.
- The first ECB hike in the refinancing rate may follow in spring 2019.

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