Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

MINUTES REVEAL ECB ON TRACK TO END QE IN SEPTEMBER 2018

Berenberg Macro Flash

The ECB is open to take the next steps: Strong growth and slowly but steadily firming inflation will probably allow the ECB to end its asset purchases in September 2018 and to raise rates in the first half of 2019. This has been our view since last autumn. The minutes of the last Governing Council's monetary policy meeting support that view and are in line with recent hawkish comments by some board members – and the lack of a dovish rebuke by others. To some extent, the minutes suggest that the ECB is warming up towards that view quicker than we thought. The euro gained and jumped to over 1.20 per US Dollar. While the ECB will avoid any unwarranted tightening, it is reassuring to see that the ECB is becoming more confident about taking the next step in its exit strategy. After all, accompanying the recovery requires less and less monetary stimulus as other factors are driving the economy.

The ECB could lean back at its December meeting, following an intense October meeting during which it had decided on major adjustments to its policy stance in 2018. The ECB will not lean back for long in 2018. The account of the 14-15 December meeting stressed that the "communication would need to evolve gradually, without a change in sequencing, if the economy continued to expand and inflation converged further towards the Governing Council's aim".

Highlights on forward guidance and policy package – guidance changes early 2018:

- The ECB kept its cards close to its chest as regards to the next steps and the timing of the end of asset purchases and the start of the rate hiking cycle. However, Governing Council members stressed that "the monetary-policy stance and forward guidance could be revisited early" in 2018. A remark was made that "a gap appeared to be emerging between favorable economic conditions and a policy stance that remained in a crisis configuration".
- The ECB discussed the transition from the present strong link between asset purchases and inflation (purchases will run until the ECB sees a sustained adjustment towards 2%) to a "broader concept of forward guidance comprising various dimension of the monetary policy stance".

Comments on inflation – both concern and comfort:

- While the ECB expressed concerns about the surprising weakness of recent core inflation readings, they explained that was partly due to "special factors" – in other words transitory factors and could, therefore, be largely ignored.
- Also, the ECB drew "some comfort" from wage dynamics (think the 6% pay rise demand by German labour unions) and continued to expect measures of underlying inflation to edge up gradually.
- Interestingly, the ECB's projected core inflation rate of 1.5% in 2019 is just an 0.1ppt below the 1999-2007 average of core inflation of 1.6%, while the 2020 forecast of 1.8% is already above it, providing another reason to withdraw stimulus further later this year (see chart).

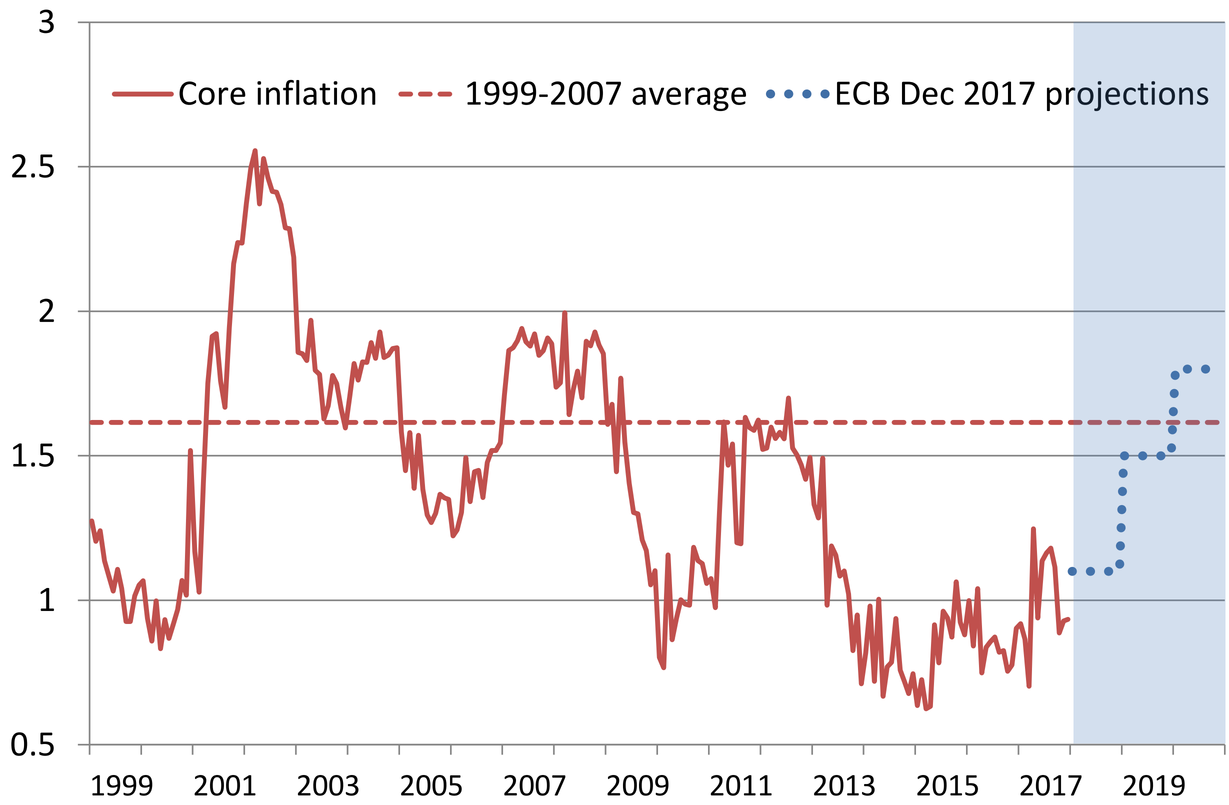
ECB outlook – QE ends after September 2018, rate cycle starts in March 2019: We expect the ECB to adjust its forward guidance and policy with a "steady hand" and step-by-step over coming quarters. The ECB will make sure that that any external communication will be in the spirit of massaging markets for the exit. We will have more hawkish ECB board member speech, followed by official forward guidance changes and actual policy action at last. More precisely, we look for the ECB to

- draw the attention throughout H1 2018 further away from net asset purchases towards interest rates, the reinvestment of maturing bonds and the stock of assets already purchased,

- drop the notion that it may increase its asset purchases in size and duration in March 2018, leaving only the more general commitment to continue asset purchases beyond September 2018 "if necessary",
- announce in June 2018 that it expects to end asset purchases in September 2018,
- adjust in September 2018 the pledge to maintain rates at present levels "well past" the horizon of QE,
- raise the deposit rate from -0.4% to -0.25% in March 2019, re-establishing a symmetric rate corridor of 25bp either way around the 0.0% main refinancing rate, and
- lift the entire rate corridor by 25bp in June 2019, followed by a further 25bp rate hike in December 2019 and roughly three further such steps in 2020.

If core inflation fails to edge up over the course of the year, and remains rather flat, there is the risk that the ECB may wait a little longer than we project.

Chart: Core inflation, the 1997-2007 average and the ECB's December 2017 projections (yoy, in %)



Annual growth rate, in percent. Source: Eurostat, ECB.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com