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ECB ACCOUNT SETS SCENE FOR MEETING IN JU…LY

Berenberg Macro Flash

The account of the ECB Governing Council's May meeting reiterated its confidence in the underlying strength of the Eurozone economy and the eventual convergence of inflation towards 2%. Governing Council members stressed that the risk of protectionism impacting the economic outlook had increased. In combination with still subdued underlying inflation pressures, the ECB once again decided caution reigned supreme – in ECB speak: "patience, persistence and prudence".

COME BACK IN JU…LY

The 14 June meeting will bring new staff projections with GDP growth likely edged down and headline inflation revised up. The next decision – an extension of net asset purchases beyond September – will, however, come unlikely before 26 July. The ECB will simply prefer to wait a little more than changing its guidance already in June. The account provided a silent nod to an end of net asset purchases at the end of 2018 ("A remark was made that survey and analysts' expectations regarding APP net purchases were unchanged, with market participants continuing to anticipate net purchases concluding towards the end of 2018").

QUOTES OF THE ACCOUNT

The account provided further comments on …

- … inflation
  - "While measures of underlying inflation continued to be subdued, some comfort was drawn from encouraging signs of a strengthening in nominal wage growth"
  - "a remark was made that the Phillips curve relationship may be non-linear, and this could support a swifter rebound in inflation when capacity constraints became binding"
- … trade tensions: "risks related to global factors, including the threat of increased protectionism, had become more prominent and warranted monitoring with regard to their implications for the medium-term outlook for growth and prices"
- … Italy: „There was broad agreement among members that it was warranted to reinforce calls for existing fiscal rules to be respected and for fiscal buffers to be rebuilt, in particular with regard to those Member States with high government debt."

POLICY OUTLOOK

All in all, the account confirms our base case of policy normalisation which is:

- announce on 26 July that it will scale back the amount of monthly asset purchases from the current €30bn from October onwards and link its guidance on interest rates more closely to the inflation outlook;
- declare on 13 September that it will purchase assets of €15bn (or €10bn) net per month from October onwards until at least the end of December 2018;
- announce on 13 December that asset purchases will indeed end in December 2018, with a chance that the ECB may disclose this on 25 October already;
- raise the refi rate by 25bp in June 2019 coupled with a hike in the deposit rate to 0% and the marginal lending rate to 0.5%;
- increase rates again by 25bp in December 2019, followed by roughly three further such steps in 2020;
- and keep the balance sheet sizeable with reinvestments of all maturing bonds to continue probably until 2021.

The meeting took place before the formation of the new Italian government, the weakish May PMIs and April core inflation. The downside risks have grown which may cause the ECB to take it slower than our base case implies. The chance of the ECB extending its net asset purchases beyond 2018 and beginning the rate cycle in September has gone up.

Still, the ECB may want to avoid any suspicion of reacting too much or even yielding to the formation of a new Italian government which plans policies at odds with the EU's fiscal rules. Meanwhile, a weaker euro and the rise in oil prices may push up the ECB's upcoming inflation forecasts by 0.3-0.4ppt within the next 12-18 months. This would make it harder for the ECB to postpone its policy normalisation too much.

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