Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

ECB: TAPERING AIN'T THE WORD FOR IT

Berenberg Macro Flash

Tapering is not the right word for it. Trying to avoid a taper tantrum, the ECB found a different way to start scaling back its asset purchases than the Fed had done three years ago. While the ECB surprised markets by reducing its asset purchases from €80bn to €60bn from April 2017 onwards, the commitment to maintain such purchases until the end of December 2017 adds an element of clarity: there will be no further reduction in asset purchases next year. Draghi even went as far as saying that the ECB didn't discuss tapering today.

Is this hawkish or dovish? Hard to say. In my view, it's neither. It simply makes sense. Under a baseline scenario of an extension of purchases by €80bn for six months followed by US-style tapering of €10bn per month, the ECB would have bought a total of €660bn of additional bonds from April until the end of 2017. Today, the ECB announced an extension of purchases by €540bn until the end of 2017. In that sense, today's decision was hawkish. However, the ECB will now end 2017 by buying €60bn in December rather than €50bn under a baseline scenario of tapering after a six-month extension of full scale purchases. Today's decision suggests that the ECB will buy more assets for longer in 2018 than assumed so far. That part of the ECB's message is clearly dovish.

Seen from a broader angle, the ECB today simply took back the increase in the size of monthly purchases which it had decided last March in reaction to widespread – if overdone – deflation concerns. As deflation risks have receded, the extra stimulus employed to counteract such risks is no longer required. However, the ECB will maintain its original pace of asset purchases, €60bn per month to keep the Eurozone recovery on track. According to Draghi, the ECB council decided with a "very broad majority" against the alternative option of extending the €80bn purchases by six months beyond the end of March 2017.

ECB SEES A "FIRMING RECOVERY"

As expected, the ECB made no major changes to its projections for growth and inflation. Upon raising the inflation forecast for 2017 from 1.2% to 1.3%, the ECB lowered its call for 2018 from 1.6% to 1.5%. For 2019, the ECB added a 1.7% projection. Although the ECB has set itself the task of stabilising inflation at "just below 2%", the 1.7% projection for 2019 would "not quite" meet the ECB's inflation goal yet according to Draghi. With such a call for 2019 and by shaving the inflation projection for 2018 slightly, the ECB can justify maintaining a very accommodative stance for a little longer than before.

As before, the ECB believes that the risks to the growth outlook are tilted to the downside. However, the ECB emphasised in its statement that is sees a "moderate but firming" recovery. On 20 October, the ECB had still talked about a "moderate but steady" recovery instead. Although the change from "steady" to "firming" is not backed by an upward revision in actual growth forecasts, it sends a moderately reassuring signal nonetheless.

Forecasts for Eurozone Inflation	2016	2017	2018	2019
ECB (December projections)	0.2	1.3	1.5	1.7
ECB (September projections)	0.2	1.2	1.6	
Bloomberg consensus	0.2	1.3	1.5	

Berenberg	0.2	1.3	1.6	

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

Forecasts for Eurozone Real GDP	**2016**	**2017**	**2018**	**2019**
ECB (December projections)	1.7	1.7	1.6	1.6
ECB (September projections)	1.7	1.6	1.6	
Bloomberg consensus	1.6	1.3	1.5	
Berenberg	1.6	1.5	1.5	

Yoy in %. Source: ECB, Bloomberg, Berenberg

TECHNICAL ADJUSTMENTS

Roughly as expected, the ECB also made some changes to the technical parameters of its asset purchase programme in order to widen the amount of German and other low-yield paper for such purchases. It did so without changing the capital key distribution of purchases between countries. First, the ECB granted itself the option to buy paper yielding less than the ECB's -0.4% deposit rate "if required". If the ECB exercises this option, the ECB or its member central banks would make a guaranteed loss on these bonds. The Bundesbank may not like it. But as yields for long-dated Bunds have risen, potential losses on some short-term paper should be offset by more interest income on longer-dated bonds. Draghi defended this move by stressing that the goal of asset purchases was to meet the price stability objective rather than to make a profit. Second, the ECB will buy bonds with a minimum remaining maturity of one year, having so far required a minimum maturity of two years.

POLITICS: "RADICALLY NEW"

Unsurprisingly, Draghi did not want to be drawn into a meaningful discussion of political risks. In general terms, he referred to political risks, explaining that Brexit and Trump may have medium-term consequences that could be hard to predict immediately. Somewhat politely, he called the Trump administration "radically new". That is probably all a cautious central banker can say, indicating through such choice of words that the ECB is watching all political risks and their potential impact rather closely. If any risks to the outlook for growth and inflation were to materialise, the ECB would stand ready to step up its stimulus again. Let's hope that won't be required.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
holger.schmieding@berenberg.com