Eurozone

ECB: Waiting for December

- **Unsurprisingly, the ECB maintained the monetary status quo at its October meeting. Mario Draghi restated the commitment to preserving the substantial amount of monetary accommodation needed to secure a sustainable return of inflation towards target.**
- **Mario Draghi specified the kind of inflation dynamics he was looking for: basically, a self-sustained inflation, which is to say an inflation driven by robust demand and wage growth. The emphasis is put on core inflation.**
- **M. Draghi dismissed the idea that has been circulating in recent weeks of an imminent tapering. However, no clue was given concerning the possibility of extending QE in December.**
- **Although the low inflation outlook argues for the extension of QE, there still seems to be major disagreements within the Governing Council concerning changes in the parameters of QE in order for it to continue.**

At its monetary policy meeting on Thursday, the ECB unsurprisingly maintained the status quo. What are the most important points to be gleaned from this meeting?

First, there is what was said, or rather reaffirmed: “the monthly asset purchases of EUR 80 bn are intended to run until the end of March 2017, or beyond, if necessary”. This dismissed the idea that has been circulating in recent weeks of an imminent reduction in the pace of monthly purchases. Although QE is bound to be tapered – an abrupt ending is highly unlikely – this is not about to happen anytime soon.

QE will continue as long as necessary to secure a sustained convergence of inflation towards the ECB’s target, i.e. inflation close, but below 2% over the medium term. Concerning this later point, M. Draghi specified what kind of inflation dynamics he meant: a self-sustained inflation, i.e. driven by robust demand and wage growth. This means that the upcoming rebound in inflation due primarily to energy-related base effects will not be considered satisfactory. From a medium-term perspective, the most pertinent indicator is clearly core inflation (excluding energy and food prices), which, in the ECB’s words, shows “no signs yet of a convincing upward trend”.

Several other points remained vague or simply went without comment. During the press conference, M. Draghi offered no clue concerning a possible extension of QE at the next meeting on 8 December. He simply said that the subject had not been discussed during the Governing Council meeting. Yet, given the *de facto* open-ended nature of QE and keeping in mind the outlook for core inflation (chart 1), there can be little doubt that such an option is being explored. M. Draghi’s restraint on the subject could indicate that there are still major disagreements within the Governing Council concerning what changes to make to QE parameters in order for it to

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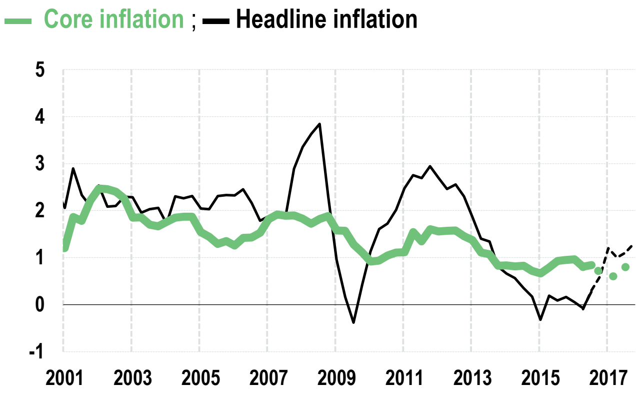

Chart Sources: Eurostat, BNP Paribas

continue. As we have explained recently[1], it is necessary to change the parameters of QE, which is why the ECB recently created ad hoc committees. There is no easy option and it seems the ECB is still working on building a consensus on the subject. The recent upturn in German yields facilitates the implementation of QE and gives the ECB some more time before making a decision.

Although extending QE beyond March still seems like the most probable option, there are still doubts about the pace of monthly asset purchases that would be applied as of April 2017. During the press conference, M. Draghi was asked if monetary stimulus was to be considered in terms of the stock or the flow of purchases – i.e. whether it was more important to consider the total amount of purchases or the pace at which they are made. Once again, M. Draghi chose not to respond, and simply stated that the subject had not been discussed. This could mean that there is different options on the table, and perhaps ongoing technical work on whether it should be a 6-month extension of QE at the current pace of monthly purchases or a longer extension of QE (say 9 months instead of 6 months), but at a smaller monthly amount (EUR 60 bn a month, instead of the current EUR 80 bn). In the second case, the total amount of additional purchases would be higher (EUR 540 bn vs. EUR 480 bn), but a reduction in the flow would risk leading to a tightening of monetary and financial conditions in the short run. We are maintaining our scenario of a 6-month extension of QE at the current pace of EUR 80 bn a month, to be announced in December.

[1] Thibault Mercier “ECB: The PSPP parameters” Ecoweek, 23 September 2016, BNP Paribas