EDITORIAL

ECB: ACCOMMODATION WITH NO END IN SIGHT

The new macroeconomic projections of the ECB staff provide sobering reading for savers hoping that, one day, the policy rate will be raised. It is clear that at the current juncture, certain conditions of the recently updated forward guidance on interest rates states are not met. Based on the latest ECB projections, it seems this would still be the case in 2023, even under the hypothesis of a mild scenario. The slow increase of underlying inflation would probably be considered as unsatisfactory. Savers can only hope that the interaction between growth and inflation will evolve or that the ECB projections turn out to be too cautious.

The ECB meeting did not bring any surprises. The recalibration of the pandemic emergency purchase programme (PEPP) was largely expected and the questions focused on whether this represents tapering or not. Christine Lagarde's tongue-in-cheek answer – *"the lady isn't tapering"* – provided clarity on the matter in plain English. The technical answer is that the PEPP has a pre-announced volume, so slightly tweaking the pace of purchases does not alter the ultimate cumulative injection of liquidity.

For the answers to the key questions – Will the net purchases under PEPP end in March next year? Will on that occasion the monthly purchases under the 'normal' asset purchase programme (APP) be increased? Will the latter benefit from increased flexibility? Etc.– we have to wait until the December meeting to get clarity on this. This is in line with the message of ECB chief economist Philip Lane who, in a recent interview with Reuters, had made it clear that the ECB is under no rush to decide, considering that ending the PEPP is not like a traditional taper because there is still the APP.

As a consequence, financial markets do not need to be informed far in advance.[1] It also gives more time to try to come to an alignment of views between Governing Council members. The ECB president somewhat teasingly felt sorry for *"those who like to set the doves against the hawks"* because the recalibration decision was unanimous[2]. Reaching a similar result in December will probably be less straightforward. Yet, the ECB will need to avoid creating the impression that it is tightening policy, because judging by the new staff projections and taking into account the central bank's forward guidance with respect to QE, this would be premature.

Admittedly, the message with respect to growth is positive. Real GDP is expected to increase vigorously this year and to remain strong in 2022. In 2023, growth should still be well above its potential. Real GDP should exceed its pre-crisis level in the fourth quarter of this year, which is one quarter earlier than previously expected and, by the end of 2022, it should be close to that expected before the pandemic. However, this positive growth outlook is not expected to cause a significant pick-up in inflation. Headline inflation should peak in the fourth quarter of this year and decline thereafter whereas underlying inflation – HICP excluding food and energy – is projected to increase slowly. This is, at least in part, related to unit labour costs, which are depressed by the expected acceleration in productivity growth. As a consequence, headline as well as core inflation should reach 1.5% in 2023, which remains well below target. Importantly, this would remain the case in a more benign scenario, whereby inflation would reach 1.7% in 2023[3].

The projections provide sobering reading for savers hoping that several years of above-potential growth would pave the way for an increase in the policy rate in the foreseeable future. The recently updated forward

1. Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Balazs Koranyi and Frank Siebelt (Reuters), 25 August 2021.
2. Monetary policy statement and press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 9 September 2021.
3. *"A mild scenario foresees a resolution of the health crisis by late 2021 and a strong rebound in economic activity... [It] envisages a higher vaccine effectiveness, also against new virus variants, and greater public acceptance of vaccines leading to only mildly increasing infections over time. This would allow for a swifter relaxation of containment measures and their phasing-out by late 2021, also leading to more limited economic costs and inducing strong positive confidence effects."* Source: ECB staff macroeconomic projections for the euro area, ECB, September 2021.

EURO AREA: REAL GDP GROWTH (Y/Y IN %)

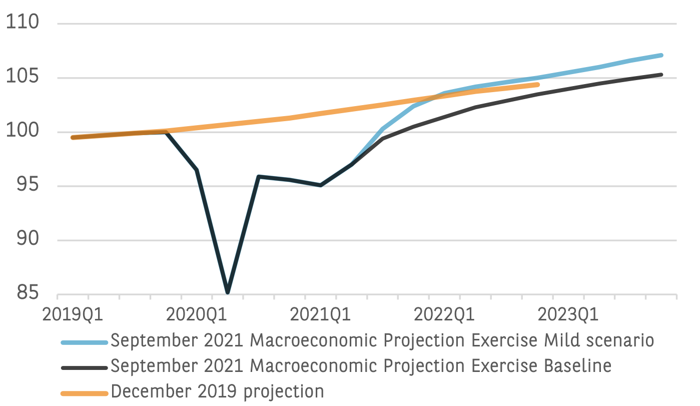

CHART 1 SOURCE: ECB PROJECTIONS, BNP PARIBAS

> The latest ECB projections provide sobering reading for savers hoping that several years of above-potential growth would pave the way for an increase in the policy rate. They can only hope that the interaction between growth and inflation will evolve or that the ECB projections turn out to be too cautious.

guidance on interest rates states that three conditions should be met before official interest rates can be hiked[4]. This is not the case today. Although headline inflation is above target, this is not expected to last. Based on the latest ECB projections, it seems this would still be the case in 2023, even under the hypothesis of a mild scenario. The slow increase of underlying inflation would probably be considered unsatisfactory. Savers can only hope that the interaction between growth and inflation will evolve or that the ECB projections turn out to be too cautious.

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EURO AREA: HEADLINE INFLATION (Y/Y IN %)

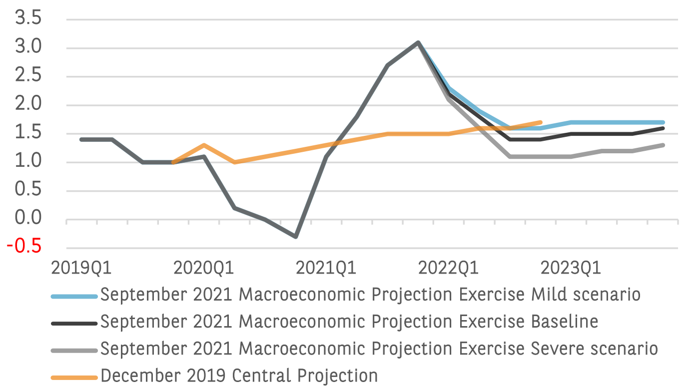

CHART 2 SOURCE: ECB PROJECTIONS, BNP PARIBAS

4. The forward guidance describes three key conditions that should be met before interest rates are raised. The ECB should see inflation reaching two per cent well ahead of the end of its projection horizon. In addition, inflation should reach two per cent *"durably for the rest of the projection horizon"*. Finally, underlying inflation should be judged to have made satisfactory progress towards the target. Source: Philip Lane, *The new monetary policy strategy: implications for rate forward guidance,* The ECB blog, 19 August 2021.