ECB Watch

AIB Treasury Economic Research Unit

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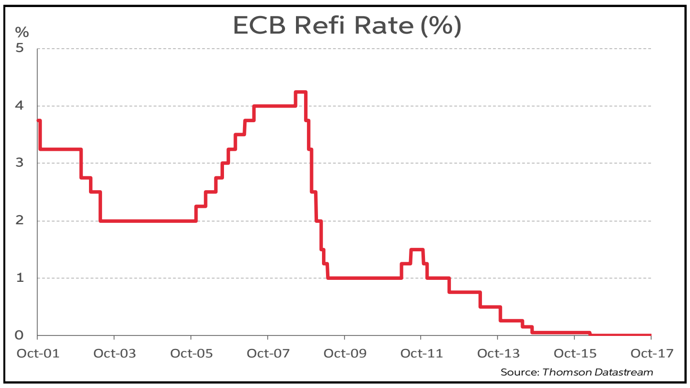
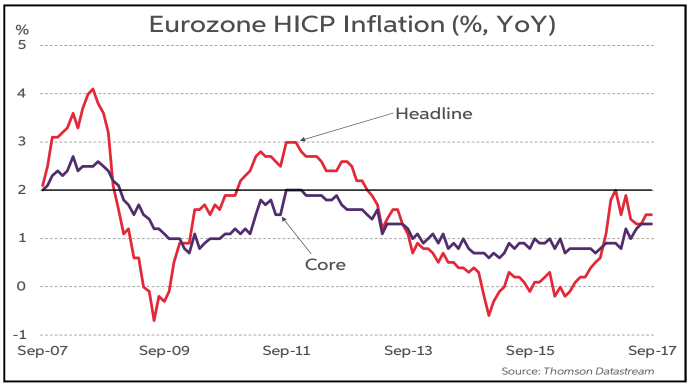
ECB to scale back QE in 2018, curbing monetary stimulus

As expected, today's meeting of the ECB's Governing Council left its key interest rates unchanged at −0.4% for the deposit rate and 0% for the refi rate. All the focus, though, was on **what the ECB would do with its asset purchase programme.** The current phase of the ECB's QE programme, with asset purchases of €60 billion per month, runs until the end of December 2017.



It was widely expected that the ECB would extend the programme well into 2018, but with a significantly lower amount of monthly purchases. The ECB delivered on this today, **announcing that the monthly purchases would be cut from €60 billion to €30 billion and that these would last until at least XXXX 2018, with a commitment to extend the programme beyond this date if necessary.**

The ECB indicated that the reduced level of purchases should be sufficient to ensure a return of inflation to its medium term target of close to but below 2%. The strengthening in economic activity over the past year means that the **same degree of monetary accommodation is no longer required.** However, as inflation is expected to remain well below target for some time yet, the ECB obviously felt that it still needs to continue with some asset purchases for a further period of time.



The **ECB staff forecasts published last month took into account the stronger growth momentum in the Eurozone economy this year**, with its near term growth expectations revised higher. The ECB now expects GDP to grow by 2.2% this year (1.9% previously). Its GDP forecasts for 2018 and 2019 were left unchanged at 1.8% and 1.7% respectively. Meanwhile, in terms of the inflationary outlook, the ECB projections see **inflation at just 1.2% next year and in 1.5% in 2019,** still well below its medium-term target of 2%, **necessitating the continuing very loose monetary stance** despite the strengthening in activity.

In summary, today's meeting announcement shows that **the ECB is continuing to proceed cautiously as it gradually moves away from an easing policy bias towards a more neutral policy stance.** Indeed, President Draghi again emphasised that that the recovery remains dependent on a continuing accommodative monetary policy. A **key element of today's decision was to keep asset purchases open ended**, with a commitment to look at further extending the QE programme beyond September next year if this proves necessary.

Meantime, the ECB also repeated again today that it expects **to keep interest rates at their current very low levels well past the point that it concludes doing monthly asset purchases.** This suggests that rates are unlikely to be hiked in the Eurozone before 2019 at the earliest. This is reflected in interest rate futures contracts, with **markets envisaging 3-month Eurozone remaining negative until end-2019 and staying low for an extended period beyond that, only reaching 1% by the end of 2022.**

In terms of market reaction, **the euro was little changed** as a reduction in QE purchases and extension of nine months to the programme period were widely expected. In level terms, this was reflected in EUR/USD continuing to trade around $1.18, with EUR/STG remaining near 89p. **Eurozone bond yields were also largely unchanged,** with the possibility of a further extension to QE beyond next September offering comfort to the market.

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