Economist's Weekly Market View

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No drama as ECB drops easing bias

Last week's meeting of the ECB Governing Council saw no changes to its key interest rates. These were left at −0.4% for the deposit rate and 0% for the refi rate. Meantime, the ECB's monthly asset purchases under its QE programme were also left unchanged, having been cut from €60bn to €30bn per month at the start of the year.

However, the ECB did remove its easing bias in relation to the QE programme. While the ECB repeated that the asset purchase programme will continue until September, and beyond, if necessary, it is no longer indicating that the size of monthly purchases could be increased if required.

In his press conference after the meeting, ECB President Draghi played down the significance of the move to drop its easing bias. He also indicated that there was not much discussion within the Governing Council about other possible policy changes. The expectation in markets is that the ECB will either halt its net asset purchases in September or extend them at a reduced level into the final quarter of the year, with the purchases then concluding in December.

The dropping of its easing bias by the ECB is another step along the path to exiting the extraordinary monetary stimulus measures that have been put in place in recent years, including the provision of enormous levels of liquidity for banks, large scale bond buying and negative interest rates.

However, the ECB is still taking a cautious approach to tightening monetary policy. President Draghi once again emphasised that the ECB expects to keep interest rates at their current very low levels well past the end of net asset purchases. This suggests that interest rates in the Eurozone are unlikely to start to be hiked until 2019.

This is reflected in futures contracts, with markets seeing unchanged rates in 2018 and anticipating that 3-month Eurozone rates will remain negative until around the end of the third quarter in 2019. They see rates staying low for an extended period beyond that, only reaching 1% at the end of 2021.

The reason for the cautious approach to monetary tightening is the expectation that inflation will remain below the ECB's 2% target over the next couple of years, as evidenced in the latest set of ECB staff economic forecasts published last week.

HICP inflation is forecast at 1.4% in both 2018 and 2019 and 1.7% in 2020, little changed from last December's forecasts. President Draghi noted that underlying measures of inflation remain subdued.

Meanwhile, the ECB's growth forecasts were upgraded slightly for 2018, with GDP now forecast to rise by 2.4% this year. It continues to anticipate growth of 1.9% in 2019 and 1.7% in 2020. Notwithstanding the impressive growth performance of the economy, as well as strong employment gains and the steady decline in unemployment, the ECB is not in any rush to tighten policy.

The reaction in markets to the dropping of the easing bias was muted. The euro rose very briefly, before settling down to its pre-meeting levels, while there was no lasting impact on bond or interest rate markets.

This subdued reaction may reflect the fact that markets had no expectation that the QE programme would be increased in size. Indeed, markets anticipate that net asset purchases will cease altogether later this year. The move to drop the easing bias then, is largely symbolic and does not signal any imminent policy change.

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