



ECB to curb monetary stimulus somewhat next year

The outcome of last Thursday's ECB's Governing Council meeting was keenly awaited by markets as it would set monetary policy for nearly all of the coming year. Rates were left unchanged as expected, at -0.4% for the deposit rate and 0% for the refi rate.

All the focus, though, was on the ECB's QE asset purchase programme. The current phase, with asset purchases of €60 billion per month, runs until the end of this year. It was widely expected that the ECB would announce an extension of the programme to well into 2018, but with a significantly lower amount of monthly purchases.

The ECB delivered on this belief, announcing that the monthly purchases would be cut from €60 billion to €30 billion and that these would last until at least September 2018. Furthermore, the ECB indicated that if necessary, the QE programme could be extended beyond this date, or it could increase the size of monthly purchases, thereby maintaining its policy easing bias.

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 observed that the latest monetary policy decisions would help inflation return towards its medium term target of close to, but below, 2%.

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 just under 2%. This is necessitating the continuing very loose monetary policy stance despite the strengthening in activity.

In summary, the meeting announcements show 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 a continuing "ample degree of monetary stimulus" is required to meet its inflation target.



A key element of last week's decision was to keep asset purchases "open ended", with a commitment to further extend the QE programme beyond next September or, indeed, increase purchases again, if this proves necessary.

Meantime, the ECB also repeated that it expects to keep interest rates at their current very low levels well past the point that it concludes doing net 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 rates 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 immediate market reaction, the euro and bond yields fell on the news that the ECB could extend its asset purchase programme beyond September 2018. In level terms, the euro fell by over two cents to \$1.16 against a stronger dollar, with EUR/GBP falling by a penny to 88.5p. Ten year German bond yields fell by 8bps to 0.4%.

Thus, while the degree of monetary stimulus is to be curbed somewhat from January, ECB policy is going to remain very accommodative for at least another couple of years.

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