

Flash Note

Euro area: monetary policy

ECB: see you in autumn

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The ECB made no change in its forward guidance at its July meeting. Importantly, the bias for QE extension “in terms of size and/or duration” was kept in the statement.

Draghi reiterated that a very substantial degree of accommodation is still needed for underlying inflation pressures to build up. During the Q&A session, Draghi mentioned that the Governing Council had not discussed an exit strategy. He also tried to reassure financial markets after his Sintra speech.

Following today’s press conference, our baseline scenario remains unchanged. We continue to expect a slow tapering of asset purchases starting in Q1 2018 and a one-off deposit rate hike in June 2018, but risks are tilted towards a delay. Specifically, we see a growing risk that a tapering announcement will be postponed to October, if not December, in order for the ECB to secure a more convincing rise in core inflation.

At its July meeting, **the ECB made no change in its monetary policy statement**, as we expected. The refinancing, marginal lending facility and the deposit rates were kept unchanged at 0.00%, 0.25% and -0.4% respectively. The ECB maintained the current monthly pace of net asset purchases at EUR60bn, scheduled to run until the end of December 2017.

The language on forward guidance was maintained: “*the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases*”. The bias to potentially lower rates further was removed in the previous meeting **on 8 June**. Importantly, **the bias for QE extension “in terms of size and/or duration” was kept in the statement**. ECB president Mario Draghi mentioned that the Governing Council (GC) was unanimous in communicating no change to forward guidance.

The GC views on growth and inflation remained broadly unchanged compared to June. The GC acknowledged that the euro area economy is enjoying a robust cyclical recovery, but that there is still no convincing sign of underlying inflation picking up, mentioning that “*we are not there yet*”. As a result, “*a very substantial degree of accommodation is still needed for underlying inflation pressures to build up*”.

During the Q&A session, Draghi mentioned that GC had not discussed an exit strategy and so no technical staff work was commissioned. **The GC was unanimous in not setting a precise date for when the discussion will take place between September and December 2017**. The GC is waiting for more information before making a decision on how to continue QE. Regarding Greece, Draghi mentioned that it is still “premature” to consider Greek bonds for purchase under QE.

Trying to reassure after the Sintra’ speech explanation

After the considerable surge in bond yields and the euro following his Sintra speech late in June, Draghi tried to reassure financial market participants by reiterating that returning inflation towards the ECB target still requires a substantial degree of monetary accommodation. He stated that the message delivered in his Sintra’s speech and in the June meeting “*were not very different*” from his communication today.

He reiterated the three main elements of his Sintra speech “[Accompanying the economic recovery](#)” several time.

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- **Confidence:** The ECB's accommodative policy is working, the economy is recovering and inflation is set to return slowly towards the ECB's objective.
- **Persistence:** Monetary policy needs to be persistent, as *"inflation dynamics are not yet durable and self-sustained...a very substantial degree of monetary accommodation is still needed for underlying inflation pressure to build up, and to support headline inflation in the medium term"*.
- **Prudence:** A very gradual adjustment is needed to avoid an unwarranted tightening in financing conditions.

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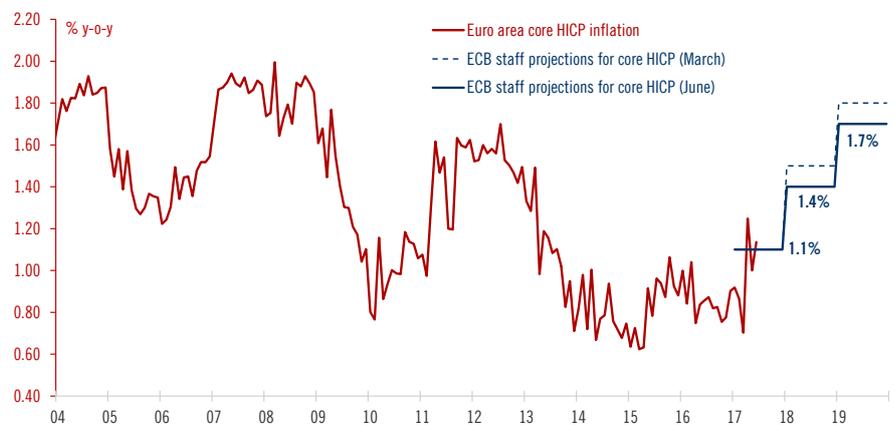
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Draghi mentioned that despite the recent euro's appreciation, financing conditions remain broadly supportive.

Overall, the broader tone of the press conference was rather dovish. **Our baseline scenario remains unchanged. We continue to expect a slow tapering starting in Q1 2018 and a one-off deposit rate hike in June 2018, but risks are tilted towards a delay. Specifically, we see a growing risk that a tapering announcement will be postponed to October, if not December, in order for the ECB to secure a more convincing rise in core inflation (see Chart 1).** In particular, our forecast suggest that euro area core harmonised index of consumer prices (HICP) inflation will start to rebound more significantly from September 2017, with the flash estimate published *after* the ECB's 7 September meeting.

Chart 1: Euro area core HICP inflation and ECB staff projections



Source: Pictet WM – AA&MR, ECB, Eurostat