

Flash Note

Europe chart of the week – ECB staff projections

ECB closer to the 2% inflation target than meets the eye

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ECB staff projections for euro area GDP growth and headline inflation have been revised up, reflecting the ECB's growing confidence over the macro outlook.

Although the 1.7% projection for headline inflation in 2020 falls short of a strict definition of price stability, the staff projections look closer to the ECB's target than annual headline inflation figures suggest. However, the steep adjustment path in core inflation looks very ambitious.

The ECB staff projections are not endorsed by the Governing Council but they tend to be used as a communication tool nonetheless. Assuming that euro area core inflation rebounds into next year as per our forecasts, we expect further upgrades to staff projections to support a hawkish change in the ECB's forward guidance at the March 2018 meeting.

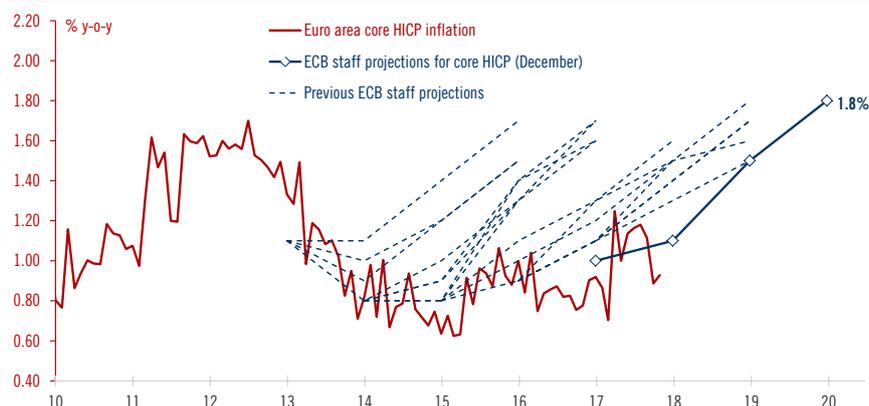
During an uneventful ECB press conference on Thursday, attention centred on the new staff projections. The headline [projections](#) were in line with expectations, albeit slightly higher on GDP growth and lower on inflation.

The key word was “confidence”- in a strong expansion leading to a “significant” reduction in economic slack, as well as in the ECB's capacity to meet its mandate. That said, ECB President **Mario Draghi was at pains to describe the 1.7% median projection for 2020 inflation as consistent with the ECB's target** of “below, but close to 2% over the medium-term”. Although we certainly did not expect the ECB to claim victory that early, Draghi could have been more explicit using the same staff projections.

First, the detailed staff forecasts are consistent with headline inflation reaching **1.8% in H2 2020**. Second, core inflation is projected at 1.8% *on average* in 2020, implying a **much steeper convergence path** toward the target given the lower starting point for core HICP, at 1.0% in 2017 and 1.1% in 2018. Meanwhile wage growth was revised higher, up to 2.7% in 2020, the highest in almost a decade, reflecting the ECB's confidence in the Phillips curve, as unemployment is expected to decline to 7.3% in 2020.

Based on our forecasts of a rebound in cyclical inflation in H1 2018, we expect the ECB staff to slightly upgrade their 2018-19 projections for core inflation at the March meeting. This would likely support further hawkish adjustments in the ECB's forward guidance, starting with the infamous de-linking between QE guidance and the inflation outlook in March, and culminating with a tapering announcement which we expect to be made in summer 2018.

Chart: ECB staff projections for euro area core HICP inflation



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

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