9 September 2021

# Flash: ECB Research

## Saving the battle for December

- At today's meeting, ECB decided to slow its PEPP bond purchases to a '*moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the previous two quarters*.' This slowdown was widely expected and probably as close to the market consensus as there could be. The entire press conference unfolded in a quite predictable fashion.
- The ECB gave further guidance of the next re-calibration to take place at the December meeting, which was widely as expected. The 'calibrate, not taper' narrative gave us deja-vu of the December 2016 press conference. Further TLTRO operations will be discussed alongside the general stance at the December meeting, but will be data dependent.
- EUR/USD was largely unchanged on the day, with Bund yields slightly lower and intra-euro area spreads tighter.

### Monetary policy considerations

President Lagarde provided only the highlights on how ECB thinks about the upcoming QE buying calibration, but fell short of commenting on what 'moderately' actual means in terms of numbers. In our view, we expect ECB to revert to a purchase pace of EUR60bn per month, as the increase from EUR60bn/month from the start of the year to the EUR80bn/month during Q2 and Q3 corresponds to 33%. Going back to EUR60bn per month would be a 25% reduction.

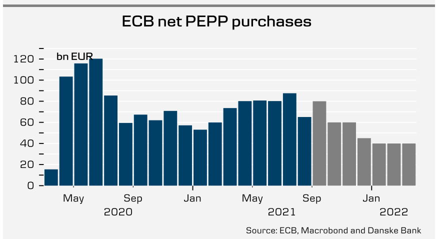
When asked about the idea proposed by Chief Economist Lane that you cannot view the APP in isolation of the net supply, Lagarde confirmed this. We estimate that for the remainder of the year, the ECB will buy between EUR 325bn and EUR 350bn, which roughly corresponds to the full gross issuance in the EGB and EU space of c. EUR 350bn.

When asked about the rising market based inflation expectations, as measured by the 5y5y inflation swap, she said that they 'pay attention' to the rise in inflation swaps, but her answer didn't have a connotation to make us judge if this is giving rise to concern at the ECB.

### Recovery on track, inflation surge still temporary

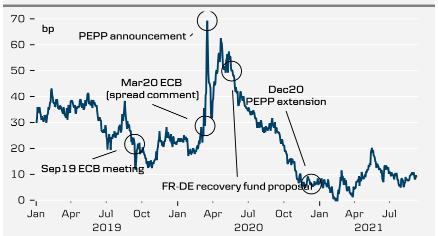
**As we expected, both the growth and inflation outlook were revised up in the new staff projections. At** the press conference Lagarde stressed that rebound phase in the recovery of the euro area economy is increasingly advanced, building on the success of the vaccination campaign. Output is expected to exceed its pre-pandemic level by the end of the year and the labour market is also improving rapidly, which holds out the prospect of higher incomes and greater spending. That said, the global spread of the Delta variant could yet slow the recovery in global trade and delay the full reopening of the economy. The number of workers in job retention schemes also remains substantial. Risks to the growth outlook are still seen as broadly balanced.

**Expected ECB PEPP net purchases**




*Source: Macrobond and Danske Bank*

**Financial tightening a determinant for PEPP implementation**




*Note: Past performance is not a reliable indicator of current or future results.*
*Source: Macrobond, Danske Bank*

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**The current rise in inflation is still seen as largely temporary by the ECB**, with underlying price pressures building up only slowly. Wages are expected to grow only moderately and inflation in the medium term is still foreseen only at 1.5%. While inflation expectations have continued to increase, they remain too far from the 2% target for the ECB's liking. That said, Lagarde also mentioned the risk that prolonged supply bottlenecks could feed through into higher than anticipated wage rises and more persistent price pressures. This will be a key focus area for ECB in the coming months.

**Overall, we largely share the ECB's cautiously optimistic outlook for the economy and transitory inflation narrative** (see *Big Picture - Delta delayed recovery*, 6 September). That said, with inflation expected to print above the ECB's target for the remainder of this year, we would not be surprised to see hawks in the ECB's Governing Council to become more vocal about pro-inflationary risks in the coming months. Fiscal rather than monetary policy will increasingly determine how the euro area recovery continues in 2022 and in that respect the outcome of Germany's upcoming parliamentary election will play a crucial role in our view (see also *German Politics Monitor - The tables are turning left*, 9 September).

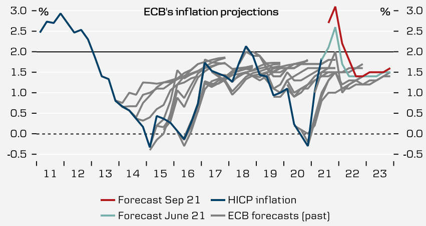
### Economic outlook has brightened

| ECB projections September 2021 | 2021 | | 2022 | | 2023 | |
|---|---|---|---|---|---|---|
| GDP growth | 5.0% (4.6%) | ↗ | 4.6% (4.7%) | ↘ | 2.1% (2.1%) | → |
| HICP inflation | 2.2% (1.9%) | ↗ | 1.7% (1.5%) | ↗ | 1.5% (1.4%) | ↗ |
| Core inflation | 1.3% (1.1%) | ↗ | 1.4% (1.3%) | ↗ | 1.5% (1.4%) | ↗ |

Parenthesis are the old ECB projections (from June 2021)

*Source: ECB, Danske Bank*

### Inflation still only seen at 1.5% over medium-term




*Source: ECB, Eurostat, Macrobond Financial, Danske Bank*

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Piet P. H. Christiansen, Chief Analyst, Aila Mihr, Senior Analyst, and Lars Sparresø Merklin, Senior Analyst.

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