

ECB Review

Draghi remains dovish until core inflation rises

The ECB kept all policy measures unchanged at today's meeting, in line with expectations.

The ECB still expects rates 'to remain at present or lower levels for an extended period of time and well past the horizon of our net asset purchases'. Regarding QE purchases, it still intends to continue these 'until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim'.

President Mario Draghi's main focus during the press conference was that the underlying price pressures remain subdued. In the introductory statement, the ECB concluded that the marked rise in inflation in December reflected mainly a strong increase in energy inflation. Related to this, the ECB concluded that it 'will continue to look through changes in HICP inflation if judged to be transient and to have no implication for the medium-term outlook for price stability'.

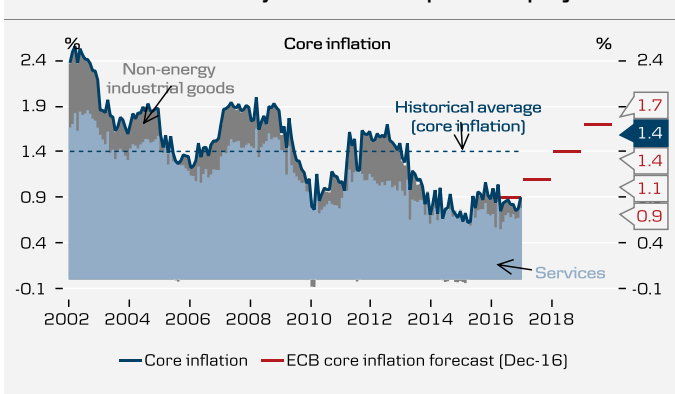
During the Q&A session, Draghi made it clear that higher inflation will not automatically result in QE tapering. Instead, four elements need to be fulfilled before the ECB will conclude that inflation is on a 'sustained adjustment'. These include that the higher inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. In our view, core inflation will stay below 1.0% on average this year, as wage pressure will stay subdued particularly in the periphery countries. Hence, we expect the ECB to continue its QE purchases in 2018 (see *Five Reasons the ECB Will Not Announce QE Tapering in 2017*, 4 January).

The ECB released further details of how it will buy assets with yields below the deposit rate but the additional information was very limited (see *link*). Purchases of bonds yielding below the deposit rate will occur only in government bonds (not covered, ABS or corporate bonds) and for each jurisdiction priority will be given to purchases of assets with yields above the deposit rate. In our view, purchases of bonds yielding below the deposit rate are likely to be needed in Germany, Finland and the Netherlands. In Germany, we estimate that at current yield, 15% of government bond purchases in 2017 will have to be conducted below the deposit rate (see *ECB QE: How much will the ECB have to buy below depo in Germany in 2017?*, 11 January).

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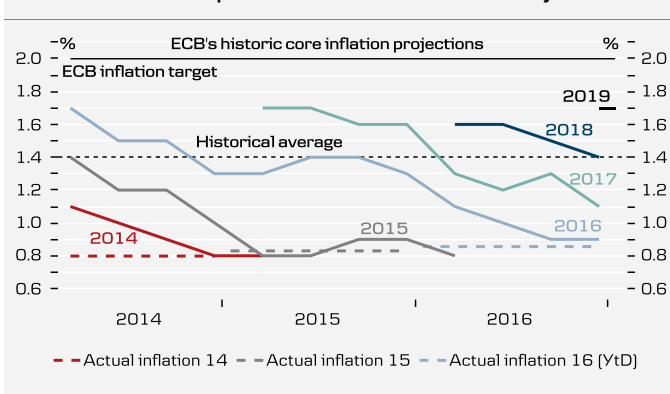
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Core inflation set to stay below ECB's optimistic projection



Source: ECB, Eurostat, Danske Bank Markets

ECB has been too optimistic on core inflation many times



Source: ECB, Eurostat, Danske Bank Markets

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Expected updates

None.

Date of first publication

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