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European Directions: September ECB meeting

Draghi prepared the ground for an announcement on the ECB's reinvestment policy later this year

All values in GBP unless otherwise noted.

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As was the case in July, the ECB meeting did not produce any tangible changes. Of course, interest rates remained untouched. As we suspected, the only change to the forward guidance was an 'update' to the part pertaining the path of QE purchases. The ECB confirmed that they will go ahead with the reduction to EUR 15bn/month from October onwards and now only 'anticipate' that the programme will be petering out after December this year.

This, 'anticipation', however, is priced as a near certainty already and it would take a massive event in global markets to derail the ECB from this track. All other elements of the forward guidance remained unaltered. We also observed that Draghi refrained from answering a more detailed question about the path and magnitude of future interest rate hikes by saying that giving such information was 'premature'.

There was some excitement – again – about whether the ECB would give a firmer steer on which form and shape the reinvestment policy would take going forward. Whilst Draghi repeated that the Governing Council had not 'discussed when to discuss it', he did acknowledge that at one of the remaining two meetings in 2018 the ECB will make a declaration. This will make matters somewhat more interesting and give markets something to hang onto – as actual policy changes will remain elusive for quite some time.

As Draghi also hinted, some 'technical work' needs to go into such an announcement and we suspect that markets will have to wait until the December meeting to get those details. Furthermore, we also suspect, that they will be delivered in the form of a technical document about implementation. Before markets get too excited, however, it is worth pointing out that Draghi suggested that the capital key remains a 'guiding principle'. Hence it seems safe to assume that there will be no intentional deviations from this metric leaving markets likely to ponder any deliberate lengthening of the purchased duration.

The final piece of information that markets were waiting for at this meeting was the update of the staff forecasts. Despite the advance headlines, the changes to the staff forecasts were marginal. GDP growth was revised down 0.1ppts in 2018 and 2019 (to 2.0% and 1.8% respectively) but the inflation forecasts were left as was, with staff continuing to project HICP inflation of 1.7% over 2018-20 (the forecasts for Q4 2020 was also left unchanged at 1.8% y/y). The downgrades to growth largely reflected weaker global growth assumptions.

Though the core inflation projection was revised lower by 0.1 ppts over 2019-20 the staff forecasts continue to show a significant increase in core inflation over the forecast period, from 1.1% this year to 1.8% in 2020, which was referenced by President Draghi during the Q&A. That largely reflects how staff see wages evolving with average wage growth accelerating to 2.7% in 2020.

Overall, markets did not take any substantial guidance from today's meeting and we, thus, continue to think that, first, the most important driver for European rates markets will remain the US market. Secondly, the European short end will find little reason to sell-off at this stage and thus any upward pressure on European yields should manifest itself more concretely at longer dated maturities rather than shorter dated ones – until the ECB starts guiding markets on their rates profile. We expect steeper EUR curves going into year end and have recommended trades accordingly through IRS and option markets.

Exhibit 1: ECB staff projections (mid-points) vs latest IMF, European Commission and OECD and forecasts

Annual percentage changes	2018					2019					2020		
	ECB	ECB	IMF*	EC	OECD	ECB	ECB	IMF*	EC	OECD	ECB	ECB	IMF
	Jun-18	Sep-18	Jul-18	May-18	May-18	Jun-18	Sep-18	Jul-18	May-18	May-18	Jun-18	Sep-18	Apr-18
HICP	1.7	**1.7**	1.5	1.7	1.6	1.7	**1.7**	1.6	1.7	1.8	1.7	**1.7**	1.7
Real GDP	2.1	**2.0**	2.2	2.1	2.2	1.9	**1.8**	1.9	2.0	2.1	1.7	**1.7**	1.8

Sources: ECB, IMF, European Commission, OECD, Haver, RBC Capital Markets * HICP forecasts from April WEO

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