# The European Central Bank is readying the future

By Christophe Blot and Paul Hubert

At the press conference following the meeting of the ECB's Governing Council on Thursday, 8 June, Mario Draghi announced that the Bank's key interest rates would remain unchanged (0% for the main refinancing operations rate, a negative 0.40% for the deposit facility rate and 0.25% for the lending facility rate). In particular, Draghi gave some valuable insights into the future direction of the euro zone's monetary policy by changing its message. Whereas he had systematically stated that rates could be cut ("at lower levels"), he now stated that they would be maintained at the "present level" for an "extended period of time" and "well past the horizon of our net asset purchases".

By announcing that there would be no further rate cuts, the ECB believes that the current monetary policy stance should enable it to achieve its objectives, and it is taking the first step towards a further tightening of monetary conditions. However, it should be noted that at the same time the ECB does not expect inflation to return to its 2% target by 2019. The Eurosystem's new macroeconomic projections published during the press conference foresee inflation at 1.5% in 2017, 1.3% in 2018 and 1.6% in 2019[1]. Although the recovery is continuing, inflation will remain below its target level for a period of at least three years, which justifies maintaining an expansionary monetary policy. By clarifying that the rates will not go up upon the termination of the net asset purchases[2], the ECB clearly intends to continue to support economic activity.

Then comes the matter of the date when the asset purchase programme will end. According to the current discourse, the purchases will continue until December 2017, but they could be extended if the ECB deems it necessary. What strategy will the ECB adopt after that? It is possible that the asset purchases will diminish gradually along the lines of what the Federal Reserve did in 2014 [3]. In this case, the end of quantitative easing would take a few more months. This is currently the most likely option, which would push off the interest rate hike until the end of 2018. It is possible, however, that announcements of a reduction in purchases could be made by year end, which could lead to winding up QE by early 2018. Whichever option is chosen, the ECB will undoubtedly take care to communicate its strategy in order to gradually shape expectations about the first rate rise.

However, while this is one important element in the strategy for the normalization of the euro zone's monetary policy, the matter is not limited to the issue of rate rises. The ECB must also provide information about its intentions regarding its negative interest rate policy or about the moment it will decide to no longer satisfy all the requests for fixed-rate refinancing, as it has done since October 2008. Finally, it also needs to indicate the pace at which it plans to cut down the size of its balance sheet as the Federal Reserve has recently begun to do (see here). The ECB also needs to be transparent on these issues.

[1] These expectations have even been revised downwards since March 2017.

[2] Since April 2017, net asset purchases have come to 60 billion euros per month, compared with 80 billion in the months before that.

[3] The Federal Reserve spread out the reduction of its securities purchases from January to October.