ECB wary of putting end-date on quantitative easing

By Balazs Koranyi
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The European Central Bank is keen to keep its asset purchases open-ended rather than setting a potentially distant date on which bond-buying will stop, to retain flexibility in case the outlook sours, three sources familiar with the discussion said.

By not saying when its net bond purchases will fall to zero, the ECB hopes to underline that there is no preset course for its stimulus programme, and that any changes remain dependent on economic data, with a special focus on wages, the sources added.

They held up the Federal Reserve's exit from its asset buying in 2014 as a potential blueprint, noting the U.S. central bank's unwillingness to publicly target an end-date.

"The Fed has done the most successful exit so it's the example for us to study," said a source who asked not to be named. "The important thing is not to pre-commit and keep it very gradual."

ECB President Mario Draghi sent a shockwave through markets earlier this month when he opened the door to potential tweaks to the quantitative easing programme. That left investors scrutinizing any potential clues to the bank's next move, which is expected to come at its Sept. 7 meeting.

ECB policymakers also meet next Thursday.

Half of analysts polled by Reuters now expect the ECB to announce in September that it will gradually wind down its asset buying, a process known as tapering, while a quarter see a one-off reduction and another quarter expect no change.

So far, the ECB has said its purchases are intended to run at their current pace until December 2017 "or beyond, if necessary" and that there would be winding-down phase after that.

The biggest challenge could be convincing markets that tapering, once started, may still be subject to change.

While the Fed emphasized the open-ended nature of its bond purchases, it scaled back the amount it bought by $10-billion at each meeting, creating the perception that it was on a preset course even if that notion was taboo.

The Fed announced its first reduction in December 2013 and ended buys the following October. Its policymakers keenly avoided the discussion of an end-date throughout the tapering process, even if markets inferred it and were eventually proven right.

The sources noted that adopting a similar strategy risked entrapping the ECB by making it difficult to deviate from a presumed schedule without generating undue market volatility.

The ECB declined to comment. The sources added that no decision has been made and the debate remains open, with new staff forecasts due in September expected to provide a key piece of the puzzle.

Wages

"How can I decide in September what we're going to do next June?" another source said. "It's got to be data-dependent and we need to preserve the flexibility."

Of particular importance for policymakers will be German wage negotiations around the start of next year and they are keen to have flexibility to respond, particularly if the results again disappoint.

While growth is accelerating and unemployment is falling quicker than expected, wage growth is anaemic, partly because unions tend to look at past inflation when tabling demands, making it difficult to escape a low inflation environment.

“Next year’s German wage deals will be very important,” a third source said. “I think unions are not aggressive enough in making their demands given rising corporate profitability.”

The ECB’s problem is that even as euro zone economic growth is on its best run in a decade, inflation is expected to remain weak, and well short of the ECB’s target of almost 2 per cent, at least through 2019.

In a possible clue about the sort of move the ECB may contemplate, Executive Board member Benoit Coeure pointed to the bank’s decision last December when it cut its asset buys by a quarter but extended the timetable by nine months.

“We scaled back our asset purchases without undermining the support given to the economy,” Coeure said in a recent interview. “So, I would argue that we have already adjusted our monetary policy ... This adjustment has been done in a very careful way, as a number of factors continue to weigh on inflation.”

If the ECB is confident its previous move was correct, it may again consider a one-off reduction with a term extension before revisiting the subject later.

Draghi argued earlier this month that with growth alone providing more accommodation, the ECB could tighten policy somewhat to keep the broad level of stimulus unchanged.