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The ECB must taper its quantitative easing with caution

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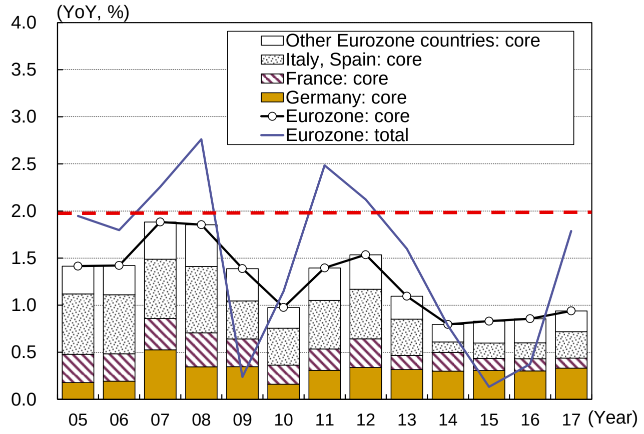
In the statement released after the European Central Bank's (ECB) Governing Council on 8th June, it said that "the Governing Council expects the key ECB interest rates to remain at their present levels for an extended period of time". The key phrase "or lower levels" was removed from this particular statement, indicating that there will be no further rate cuts unless the economy worsens significantly. Meanwhile, the policy rate remained unchanged. In the ECB's projections for the Euro Area, also published on 8th June, their forecast for the real GDP growth rate was revised upwards by 0.1% for every year up until 2019. However, the HICP inflation rate forecast was revised downwards: 1.5% year-on-year (YoY) in 2017 (down by 0.2% from the previous projection), 1.3% YoY in 2018 (down by 0.3%) and 1.6% YoY in 2019 (down by 0.1%). This suggests that while the economic recovery is progressing gradually, the ECB does not foresee that it will meet its inflation target of "below, but close to, 2% over the medium term". At a press conference after the meeting, President of the ECB, Mario Draghi, repeatedly stated that it would be difficult for inflation to reach its target for the time being. He also said that further decreases to the amount of asset purchasing after the end of December 2017 had not been discussed and emphasised that the ECB's stance towards monetary easing had not changed.

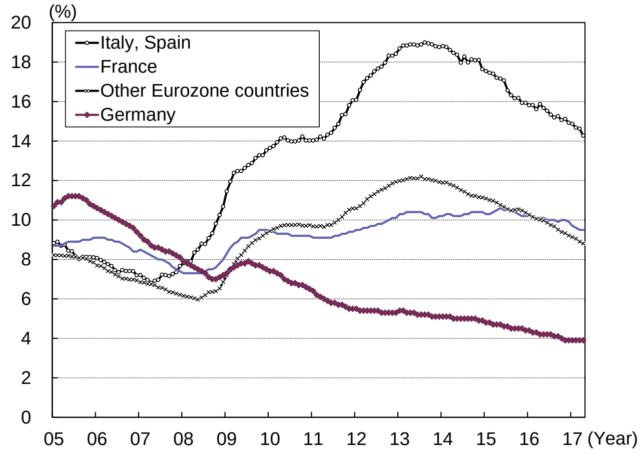
The ECB's approach to tapering its monetary easing is cautious as it is keeping an eye on countries where the economic recovery is relatively slow. If we compare the Eurozone's latest core inflation rate with that of the period from 2007 to 2008 and 2011 to 2012, where inflation reached the ECB's target, it is clear that while Germany's contribution has remained the same, France, Italy and Spain's contributions have shrunk (Chart 1). Furthermore, the unemployment rate in Germany continues to fall, whereas it remains at a high level in France. In Spain and Italy, the unemployment rate still greatly exceeds the pre-financial crisis level (Chart 2). There is a clear disparity between how strong each country's inflationary pressure is due to differences in the pace of economic recovery. In Germany, government officials and the President of the Deutsche Bundesbank, who are concerned that easing has gone too far, continue to say that monetary policy should be normalised soon, but other countries deem this as premature. Unlike the US Fed and the Bank of Japan, the difficulty of policy management in the case of the ECB is that it undertakes the monetary policy of 19 countries single-handedly.

Chart 1: Eurozone Consumer Price Index



Note: Data for 2017 is an average of January to May.
Source: Eurostat, BTMU Economic Research Office

Chart 2: Major Countries' Unemployment Rate



Source: Eurostat, BTMU Economic Research Office

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