

# Europe's exit from QE

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At its meeting this week, the European Central Bank decided to hold off until October before making a statement on withdrawing monetary stimuli, i.e. ending QE. So, unless some sort of risk materialises, one of the great unknowns with regard to how monetary policy strategy will be implemented has been cleared up, namely the timing. There is absolutely no doubt that the improved economic conditions in the eurozone, where growth has gathered pace to a touch over 2% and inflation has steadily increased, and the lower level of political uncertainty on the domestic front, support this move.

With the question of when decided, this now leaves the next unknown to be clarified: the matter of how this will be done. The process is a complex one, since it encompasses several different aspects, and the ECB is not giving any clues.

What do we know about the strategy? That it will be tackled in at least two phases. First will come the exit from the bond purchasing programme and then, only once a "good" length of time has passed, interest rate hikes will begin, i.e. tapering. This sequence, which was established some time ago, represents a key communication element to guide market expectations. This is why this was heavily underscored by Draghi last Thursday, his aim being to keep rate hike expectations anchored in Europe. For the time being, this is mission accomplished, as markets are not factoring in rate hikes until well into 2019. Regarding how the Bank will change its purchasing programme, the scenarios currently being weighed concern quantities and duration rather than other parameters, such as the ceiling on purchases or the asset split therein. The final strategy is highly likely to be defined in such a way as to provide the central bank with maximum flexibility without any surprises along the way, so that it can gradually bring the programme to its conclusion before next autumn.

Which variables are key? Unlike the US Federal Reserve, which has a twofold mandate for both inflation and job creation, the ECB only has one, which is inflation. This means that the evolution of prices in the eurozone and, in the final analysis, any variable conditioning that evolution, are the issues to watch for. And this is where the euro has come to take centre stage. The single currency's sharp gain in strength, and not just against the dollar, has been a major factor behind the recent downward revision of eurozone inflation forecasts. This has nonetheless been very moderate, as the deflationary pressures of a strong euro are being offset by notable buoyancy in terms of domestic demand. That said, the euro is becoming a factor in uncertainty looking ahead, which is why the ECB will be paying special attention to it.

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