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ECB expected to finish QE end of this year

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QE has been a controversial policy wherever it has been implemented, including in the euro zone. With the economy having expanded at the fastest rate in a decade in 2017, the ECB has already begun to scale back its asset purchases from EUR80bn per month at the peak to EUR30bn currently. The ECB is due to make its next decision on QE this summer. Our baseline expectation is that the ECB will announce in July the intention to finish QE at the end of this year. That will be a signal to markets and the economy that it is just a matter of time before the ECB's other controversial monetary policy – negative deposit rates – is also withdrawn.

We have looked at the framework within which the ECB will make the decision to exit QE. The ECB needs to believe that a sustained adjustment in the path of inflation has been achieved. There are three forward-looking criteria that need to be satisfied to make this judgement. The ECB needs to (a) believe that inflation will converge back to its objective of below but close to 2%, (b) be confident about the convergence of inflation back to the objective and (c) believe that convergence will be resilient to the cessation of QE. A few months ago the ECB describe the judgement as being "close". On the basis of the evidence, we agree.

However, as close as the ECB is to taking this historic decision to end QE, the risk is that the exit from QE has to wait a little longer. The reason is not related to Italy – the three exit criteria are designed to de-politicise the QE exit decision. The reason is the need to understand whether the unexpected slowdown in economic growth is temporary or not and whether still subdued core inflation means forecasts for normalisation remain too optimistic.

Our base line view of an QE exit announcement in July is conditional on GDP growth re-accelerating in Q2, core inflation moving back to c.1% after Easter and an unwarranted tightening of financial conditions — for example, because of uncertainty triggered by Italy's new government — being avoided. The dovish risks include a delayed exit decision — potentially until September — a temporary further extension of QE at a slower rate and a decision to trade off ending QE against a strengthening of forward guidance.

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