Daily Insight

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ECB Superhawk backs rate guidance

ECB View: Weidmann against QE but backs rate guidance – Bundesbank President and ECB Governing Council member Jens Weidmann argued once again for a faster end to the asset purchase programme. Speaking at an event on Friday, he argued that 'a faster end to net asset purchases with a clearly communicated end-date would have been justifiable'. However, more noticeably, given he is on the most hawkish end of the Governing Council spectrum, Mr Weidmann gave his support to the forward guidance on interest rates. He said that 'as far as central-bank interest rates in the euro area are concerned, however, the immediate risk of change is currently low. After all, the Governing Council has made it clear that interest rates will remain at their current levels for a longer period of time and well beyond the time horizon of net asset purchases'. He added that 'the full normalization of monetary policy will therefore be a long path'. It is unclear what is meant by 'well beyond' but we take that to mean around 6 months. This means that if the QE programme was to end abruptly in September 2018, an interest rate hike would not follow until March 2019. However, ECB President Draghi made it clear that the programme would not stop abruptly. At the ECB October 2017 Governing Council meeting, Mr Draghi emphasized the open-ended part of the QE programme and gave some signals that in the case of no further extension a tapering period would follow. Given a tapering period of 3-6 months, the first deposit rate hike would not follow until June – September 2019 (our base case is 6 months of tapering with the first hike in September 2019). The rate guidance suggests to us that financial markets are pricing in a too aggressive path for ECB interest rate hikes. According to EONIA forwards, the market assigns a 70% likelihood of a 10bps deposit rate hike in December of this year. In addition, the market has fully priced in a 15bps rate hike in the first quarter of 2019, while it expects the ECB to hike again by 10bps in the third quarter of 2019. (Nick Kounis & Kim Liu)

US Macro: Inflation – Recovering, rather than heating up – Core CPI inflation for December surprised to the upside on Friday, rising the most since January on a month-on-month basis (0.3%; consensus: 0.2%; November: 0.1%). Inflation rose 1.8% yoy, the highest since April. The acceleration was fairly broad-based, though autos and transportation services were a particular support – explaining 1/3 of m/m inflation – having collectively made negative or neutral contributions through most of 2017. On a 3m/3m saar basis, core inflation has recovered to 2.3%, suggesting inflationary momentum may finally be building. However, we feel it is too soon to get excited, for two reasons. First, inflation is recovering after a period of surprising weakness, given the tightness in the labour market. Average m/m core inflation was just 0.15% in 2017, the weakest since 2014 – when unemployment averaged 6.2%, 2.1pp higher than today, and the Fed was still engaged in asset purchases. Second, we do not see significant cost pressures emerging from the labour market. Granted, there are some qualitative signs that wage growth may finally be accelerating – Walmart, the biggest single employer in the US, last week announced it would raise its minimum wage from $9 per hour to $11. However, high corporate profit margins, helped by the recent tax cuts, mean such rises are unlikely to lead to cost-push inflationary pressures in the near term. Indeed, as we discuss in our 2018 US Outlook, unit labour cost growth has turned negative in recent quarters, on the back of a recovery in productivity. Weak ULC growth should keep inflation lower for longer than the Fed is currently projecting, in turn leading to a gentler rate hike profile – we expect two 25bp hikes this year, against consensus/FOMC projections of three hikes. (Bill Diviney)