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TRENDMACRO LIVE!

On the ECB's QE Taper Announcement

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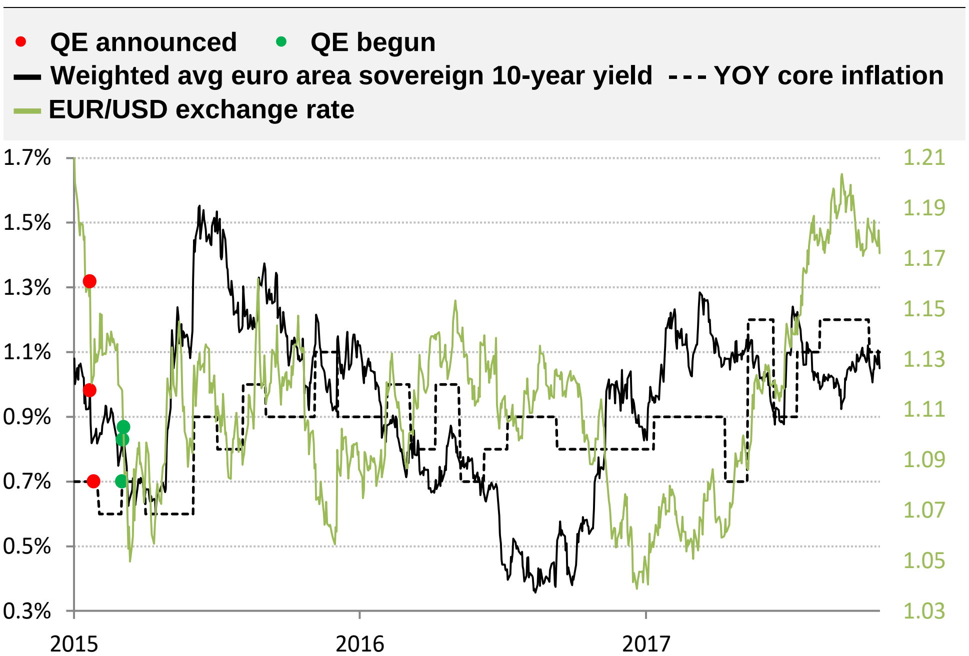
Donald Luskin

"Whatever it takes" takes less now. Euro QE did nothing, and tapering it is a non-event.

This will be a brief note, because its purpose is only to convey our belief that *the European Central Bank Governing Council announcement this morning – that it will taper its bond purchases from €60 billion to €30 billion per month – is not a significant development for Europe, the global economy, or global markets.* It was fully expected. And it's not even the first taper announcement – the ECB announced tapering from €80 billion to €60 billion last December. As of this writing, the euro is weaker, not stronger; euro area bond yields are lower, not higher; and equities are higher, not lower. Nothing to see folks. Move along.

- Why should tapering matter? It would seem that the ECB's QE itself didn't matter. Originally announced as intended exclusively to get inflation to the ECB's mandate of 2% (after all, price stability is the ECB's sole mandate, so it *had to* say that), it at least moved inflation in the right direction (please see the chart below).
- Market participants understood that would be achieved by lowering euro area bond yields and weakening the euro. But, if anything, the opposite has happened (again, please the chart below).



Source: Bloomberg, TrendMacro calculations

Update to strategic view

ECB, EUROPE MACRO, EUROPE BONDS, EUROPE STOCKS, FX: The ECB will taper its bond purchases from €60 billion to €30 billion per month. This is a non-event. Over its almost three years, euro area QE has done nothing to lower bond yields or weaken the euro (both have moved in the opposite direction), but inflation has improved slightly. Once at least arguably a necessary form of forward guidance, to convince the market that the ECB would do "whatever it takes," even that is no longer necessary in today's risk-tolerant world. This is a non-event.

[Strategy dashboard]

- As we said at the outset (see "On the January ECB Policy Meeting" January 22, 2015) – and as we have said about normalizing the Fed's balance sheet (see "Time for Taper Tantrum Two?" April 6, 2017) – QE simply doesn't have these effects. It tends to have the opposite effect.
- Operationally, all QE does is lower the average maturity of assets held by the private sector (thus requiring the private sector to take a little less risk). The same thing could be accomplished without central banks at all, by national treasuries simply deciding to issue shorter-maturity debt.
- Psychologically, QE can be seen as form of forward guidance, designed to emphatically indicate that policy will be accommodative for a long time (see "The Trouble with Taylor" October 24, 2017). Following this morning's announcement, the euro money market curve upped its expectations for ECB rate hikes by a not-very-dramatic 7 basis points for the coming three years.
- QE is also theater – a grand gesture, designed to convince the market that a central bank will do "whatever it takes." When ECB President Mario Draghi famously used that phrase in July 2016 (see "On Draghi in London" July 26, 2012), it was at the worst of a sovereign debt crisis infecting Italy and Spain. It was nothing but a verbal intervention, and a successful one. The emergency Outright Monetary Transactions program that resulted from it never had to be implemented.
- Two years later, the ECB's QE was implemented as "foam on the runway" in anticipation of the radical SYRIZA party taking power in Greece, which had been the symbolic flash-point of the euro area's rolling debt crisis (see "Here Come Greek Elections -- and QE from the ECB" December 30, 2014).
- *The world was a risk-averse place then. Now it is a risk-tolerant place. All QE does is reduce the demand on the private sector to take risk – by shortening maturities, and by putting out comforting forward guidance. That's not necessary any more. It's time to taper, and it will be just fine.*

Bottom line

The ECB will taper its bond purchases from €60 billion to €30 billion per month. This is a non-event. Over its almost three years, euro area QE has done nothing to lower bond yields or weaken the euro (both have moved in the opposite direction), but inflation has improved slightly. Once at least arguably a necessary form of forward guidance, to convince the market that the ECB would do "whatever it takes," even that is no longer necessary in today's risk-tolerant world. This is a non-event.

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