INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Governing Council meeting, ECB. 22/7/2021.

ECB assumes June's fall in inflation means that it won't be a problem.

On 22nd July, the Governing Council of European Central Bank met for the first time since the announcement of a change to its inflation target in its strategy review. Instead of aiming for inflation to be "below but close to 2%", the new objective will be for a symmetric inflation target of 2%. There were no new announcements, although the Governing Council reaffirmed its commitment to step up the purchase of assets under the €1,850b. Pandemic Emergency Purchase Programme (PEPP). Although the ECB first made such a commitment in March, the actual volume of assets purchased has been more or less static following a slight rise in April. The ECB also reiterated that there will be no run-off of assets before the end of 2023 and that the separate 2019 asset purchase scheme of €20b. will continue until inflation has reached 2% or more for a sustained period.

After acknowledging at its previous meeting that inflation may well exceed its new target value of 2%, the ECB claimed that the drop in CPI from 2% in the year to May to 1.9% a month later has fully vindicated its stance in not tapering the asset purchases under PEPP. Strangely enough, the policy statement from Christin Lagarde then reiterated a belief that inflation would rise higher before falling back below 2% in early 2022. No mention was made about the pick- up in broad money growth during May. An annualised quarterly rate of 5% is on the high side, although not exceptionally high. (April's figure was 4.8%) However, this 5% figure has been achieved at a time of weakness in both consumer credit and business lending as the Eurozone economy is still not fully opened up. As restrictions are eased further, bank lending is likely to pick up. This creates new deposits, which are money. Assuming the ECB carries on with its asset purchases at the current (or an increased) level, broad money growth is likely to rise well above 5% and the ECB's insistence that inflation will only be transitory could well prove wide of the mark.

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