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EUROZONE

Trend in inflation argues for ECB flexibility in both directions

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One higher inflation figure is not a tipping point, but the latest numbers (and good purchasing manager indices) show that surprises in every direction are possible. Although the next ECB Council meeting is still likely to be too early, the ECB should replace its one-sided bias to expand its bond purchasing program if things turn out worse than expected with a balanced statement soonest.

Today's flash estimate shows a jump in eurozone inflation to 1.1% in December (November: 0.6%). Alongside energy prices, this was fueled by the unprocessed food component. Core inflation (stripping out energy and unprocessed food) edged up marginally to 0.9% on a year earlier. As early as January the headline inflation rate in the eurozone will climb further to around 1.5% and later in the year approach 2%. Via higher import prices, the weaker euro will also be making itself felt.

At the last ECB press conference President Draghi was asked whether bond purchases could be reduced if things developed better than expected. He answered that this had not been discussed in the ECB Council – such a "high-class problem" seemed to be fairly far away. We believe, however, that there is every reason to place more confidence in the performance of the eurozone economy. This is underpinned for instance by the results of the purchasing managers survey published today. The composite index for the eurozone rose to 54.4 points in December, the highest for more than 5 years. Economic growth this year is likely to come in at 1.6% as last year.

In our view the ECB should abandon its one-sided preparedness to ramp up the bond purchasing program again (reduced from EUR 80bn to 60bn from April 2017) should adverse circumstances require. Instead it should also expressly give itself room to rein in bond purchases more swiftly than currently planned. Regardless of whether this is labeled tapering or not, yields are bound to move up to a certain extent. But this will be limited as the ECB will certainly not be reducing its presence on the market abruptly.

These assessments are, as always, subject to the disclaimer provided below.