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ECB: EXTENDING A HELPING HAND FOR LONGER

Berenberg Macro View

More support for longer. The European Central Bank (ECB) today delivered roughly what markets and we had expected. This may have been the ECB's last big push to fight the Covid-19 recession, but it remains to be seen whether it is its last big push to fight low inflation.

In response to a yet again sizeable downgrade in inflation projections and a first 2023 inflation estimate of just 1.4%, the ECB vowed to maintain very favourable financial market conditions well into 2022. The additional €500bn purchases under the Pandemic Emergency Purchase Programme (PEPP) and the three more Targeted Long-term Refinancing Operations (TLTROs) were at the low end of our expectations. But the ECB extended its PEPP purchases until March 2022 and the date until when it will reinvest the maturing proceeds in full to the end of 2023. Together with more rounds Pandemic Emergency Longer-Term Refinancing Operations (PELTROs), the ECB today delivered the package it had raised in the last few weeks.

While the ECB is providing strong incentives for banks to lend to the private sector, we had hoped for somewhat stronger signals with respect to counteracting a potential further tightening of bank credit standards and enhancing the transmission of its policy stance – think of a lower lending threshold for the TLTROs or allowing banks to re-price their existing loans to the cheapest lending rate of -1%. Contrary to what we had expected before today's meeting, the ECB has made it "slightly more challenging" for banks to qualify for the cheapest lending rate. Still, some other adjustments will further enhance the transmission of the monetary stimulus to the real economy. The ECB extended the period over which the TLTROs cheapest lending rate applies until mid-2022 as well as banks' relaxed collateral requirements and raised the share from 50% to 55% of banks' stock of eligible loans they can borrow and extended the period.

The ECB – like central banks across the globe – makes it easy for countries to shoulder the high costs of the pandemic. This helps governments to spend big to limit the damage of the second wave and reinforce the recovery from spring next year. Once the second wave of the pandemic has run its course, the tailwinds from ample monetary and fiscal support should provide a noticeable boost to the economy. That the EU seems to have resolved their dispute over the €1.8trn fiscal deal and payouts could start flowing as planned by mid 2021 is good news for the EU economy and the ECB. Reading between the lines, the ECB probably hopes for some governments to extend their credit guarantees. This could arrest a tightening of bank credit standards from the demand rather than the supply side.

By indicating that it is monitoring "very carefully" the exchange rate, the ECB did some soft verbal intervention. However, since the Fed is also pursuing an extraordinarily aggressive monetary policy and capital flows from the dollar back to emerging markets keep a lid on the US dollar, the ECB's policy package is unlikely to have a lasting impact on the euro relative to the US dollar. We expect the US dollar to depreciate further to 1.25 against the euro in the course of 2021.

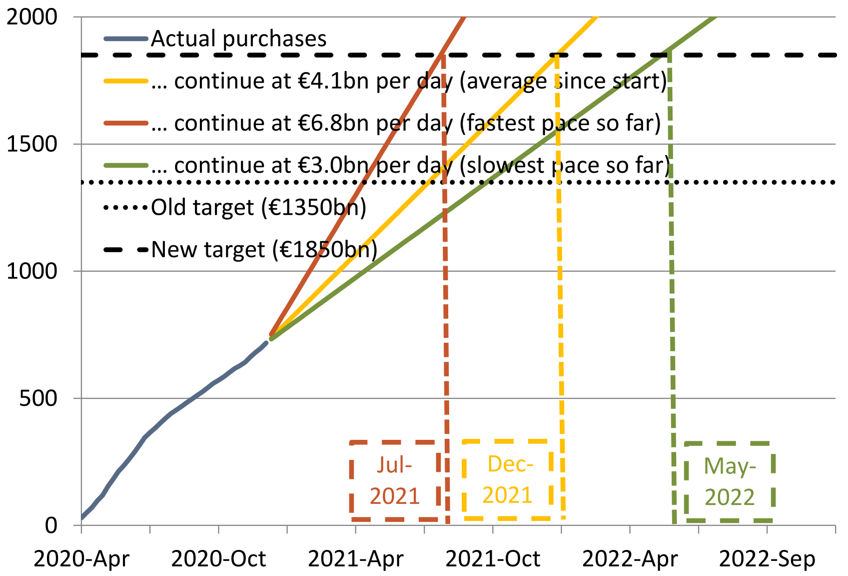
FORECASTS
The ECB has raised its projection for **real GDP growth** in 2020 from -8% to -7.3%, broadly in line with our own estimate of -7.5%. Reflecting the ECB assumption of a delayed recovery, the ECB is less optimistic for growth in 2021 (3.9% vs. 5.0% before and our estimate of 5.1%) but expects the economy to expand at a higher rate in 2022 (4.2% vs. 3.2% before and our estimate of 3.5%). For 2023, the ECB forecasts above-trend growth of 2.1%.

Headline **inflation** was running below the ECB's projections already before the start of the second wave despite the surprisingly strong Q3 rebound in economic activity. Amid the Q4 contraction of the economy, the disinflationary trend continues. The ECB lowered its 2020 call from 0.3% to 0.2%. It maintained its 2021 call at 1% as it expects a strong impact from the return to the (higher) normal VAT rate in Germany and energy base effects (Berenberg forecast: 0.8%). The ECB, however, brought down its 2022 estimate from 1.3% to 1.1% and only expects inflation to average 1.4% in 2023, significantly below the 1.6% we had expected.

POLICY OUTLOOK
Was this the last Covid-19 push? Amid the continued uncertainty, the ECB is keeping its options open. ECB President Christine Lagarde explicitly pointed out that the ECB may not need to fully utilize the framework for bond purchases – or it could step it up again if financial conditions deteriorate. The ECB also stressed that any self-imposed limit would be an obstacle to be removed if deemed appropriate for the proper conduct of monetary policy. The low 2023 inflation estimate suggests – in the absence of significantly more fiscal stimulus – more monetary easing through its standard Asset Purchase programme (APP) may be needed after the PEPP has run its course – something we have pointed to in the summer, see ECB asset purchases: not proportionate, yet.

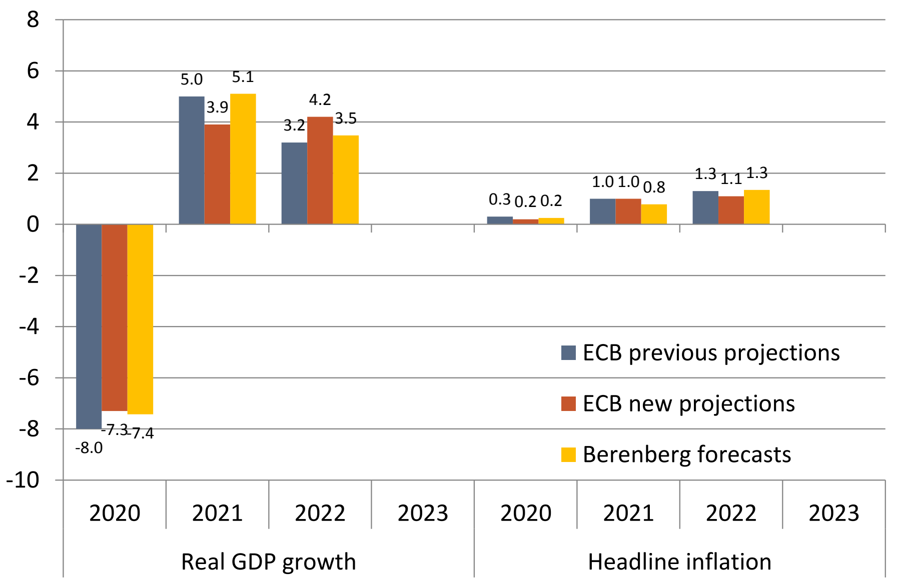
Please click here, for our flash comment in response to the press release of the ECB's monetary policy decisions.

Chart 1: Projections of when ECB will hit new PEPP target



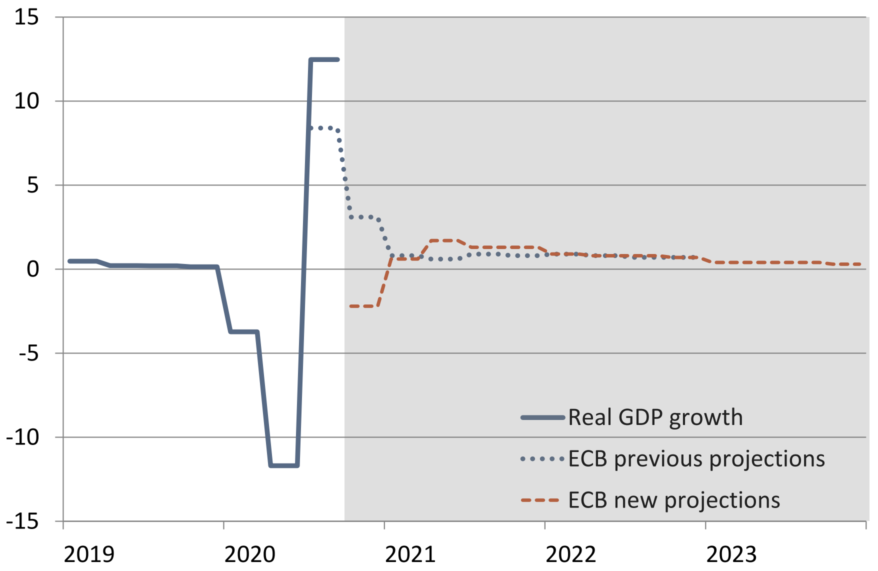
In bn euros. Sources: ECB, Berenberg.

Chart 2: ECB projections vs. Berenberg estimates (yoy, in %)



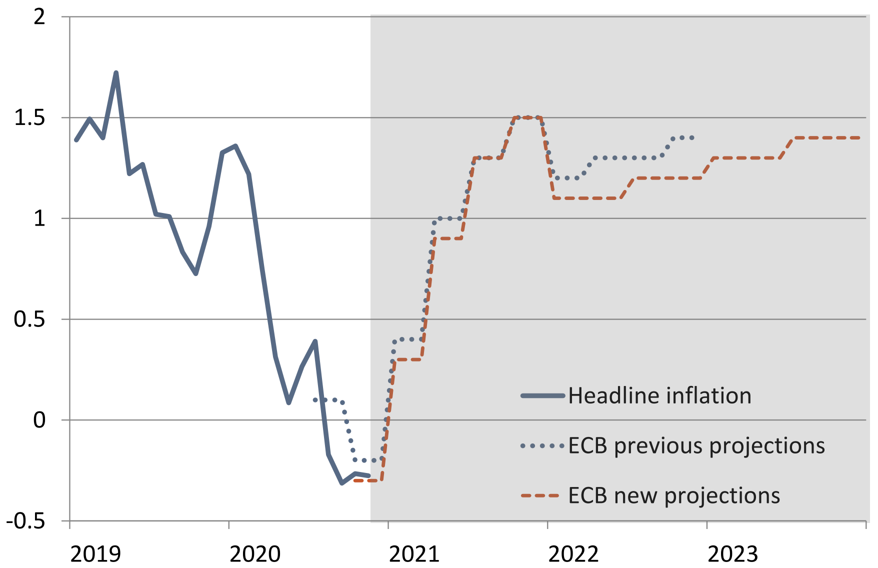
Sources: ECB, Eurostat, Berenberg.

Chart 3: Real GDP growth – ECB old vs. new projections (yoy, in %)



Sources: ECB, Eurostat, Berenberg.

Chart 4: Headline inflation – ECB old vs. new projections (yoy, in %)



Sources: ECB, Eurostat, Berenberg.

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