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ECB FLASH: LAGARDE DELIVERS A SENSIBLE PACKAGE

Berenberg Macro Flash

An acute crisis requires swift action. Mario Draghi knew that, and so does Christine Lagarde. The European Central Bank today announced a package of measures to limit the risk that second-round effects could severely exacerbate the economic damage from the Covid-19 pandemic. However, contrary to expectations, the ECB did not cut its deposit rate more deeply into negative territory. Instead, the ECB will buy more assets with a focus on private sector bonds and inject even more liquidity at even more favourable terms into the banking system. In its statement announcing the monetary policy decision, the ECB emphasised that it does not see "material signs of strains in money markets or liquidity shortages in the banking system".

As an even more negative deposit rate would not have done much to support credit growth, keeping deposit rates unchanged makes sense. However, it raises the risk that the euro may appreciate at a time when the US Fed seems poised to cuts its Fed funds rate again by 50bp next Wednesday. As a result, some observers may initially view the ECB package as somewhat underwhelming. However, the long-term liquidity injections with a rate 25bp below the deposit rate can be seen as a rate cut in disguise.

The key measures:

- additional long-term liquidity injections at favourable conditions to provide immediate support;
- the already planned longer-term liquidity injections (TLTRO III) will be made even more favourable with a rate up to 25bps below the -0.5% deposit rate;
- an increase in net asset purchases by €120bn until the end of year, that is roughly €12bn on average over the remaining 10 months in 2020 or 20bn for six months on top of the current monthly amount of €20bn, with a focus on private sector bonds such as corporate bonds;
- collateral easing measures to ensure that counterparties remain able to make full use of the funding support.

Right after the ECB statement, the European Banking Authority (EBA) announced that it will postpone the next EU-wide banking stress test to 2021. The EBA also urged national regulators to make full use of the flexibility in bank regulations. That should make it easier for banks to keep up the flow of credit to companies shortly.

The targeted liquidity injections, additional purchases of corporate bonds and regulatory changes can be useful to prevent a credit squeeze at a time when companies may soon need bridging loans at generous conditions to tide them over cash-flow problems.

Not quite the circuit breaker to end the recession

None of the ECB's measures or any other monetary, fiscal or regulatory policy initiative can be the circuit breaker in the recession into which the Eurozone seems to have fallen this month, in our view. But the ECB package, and further steps by bank supervisors as well as by fiscal policy, can limit second-round effects. The ECB today has made it even less likely that the severe Covid-19 shock to the real economy could morph into a financial crisis. The ECB package also raises the hope that, once the medical outlook has become clearer, the Eurozone economy will be in a better position than otherwise to recover from the current severe shock to supply and demand.

We will send out a full assessment after the press conference that will start at 13:30h GMT.

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