Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

# ECB TWEAKS GUIDANCE DESPITE NEW UNCERTAINTIES

## Berenberg Macro Flash

Unfazed by the triumph of populist parties in Italy and by trade tensions triggered by the US, the European Central Bank today took a further step towards the exit from its ultra-loose monetary stance. In its formal **policy guidance**, the ECB dropped the notion that it "stands ready to increase the asset purchase programme in terms of size and/or duration" if required. We had expected the ECB to do so six weeks later, at its April meeting. This pledge had been part of the ECB's guidance since December 2016.

All in all, today's ECB statement exudes confidence that the Eurozone economy will continue to enjoy robust growth. As our own forecasts are slightly above those of the ECB, we fully agree with the assessment. Celebrating the "strong and broad-based growth momentum" in the Eurozone and emphasising that the outlook for growth "confirms our confidence that inflation will converge towards our inflation aim" of below, but close to 2%, the ECB dared to surprise markets slightly by tweaking its forward guidance today. According to ECB president Mario Draghi, the ECB took this decision unanimously.

The ECB did acknowledge the emergence of new risks, prominently adding "rising protectionism" as the first item on its brief list of downside risks to growth. Nonetheless, the ECB raised its growth forecast slightly for 2018 from 2.3% to 2.4%, just one notch below our above-consensus call of 2.5%. As before, the ECB assessed the risk to growth as "balanced". Following the recent stability in the exchange rate, the ECB slightly toned down its warning that a stronger euro may represent a risk to growth, mentioning the exchange rate as a factor to be monitored rather than as a source of uncertainty, as it had done on 25 January 2018.

When asked about the potential damage of **trade tensions**, Draghi pointed to three issues to watch in order to assess the potential impact: (1) will there be retaliation, (2) will the exchange rate continue to react as before, namely with an appreciation of the US dollar amid trade tensions, and (3) will trade tensions hurt confidence. We share Draghi's view that the potential confidence effect would be the most important channel through which trade tensions could weigh the growth and inflation outlook. We look for a dent in Eurozone business confidence measures for manufacturing in coming months that likely will not be pronounced enough to affect actual GDP in a meaningful way. Of course, if the US were to start a genuine trade war, the outlook would worsen, for the export-oriented Eurozone more so than for the US.

When asked about **Italian politics**, Draghi drily observed that markets have not reacted in a way that undermines confidence. Nonetheless, he warned in general terms that protracted political instability could still do so.

### ECB PROJECTIONS: FODDER FOR HAWKS AND DOVES

The new ECB projections provide some fodder for both hawks (slightly stronger growth in 2018) and doves (mildly lower inflation in 2019). Reacting to a somewhat faster-than-projected economic expansion in the short-term, the ECB raised its 2018 call for real GDP growth from 2.3% to 2.4%. The ECB, however, left its projections for 2019 and 2020 unchanged (1.9% and 1.7%, respectively). As before, the ECB looks for the upswing to lose momentum in the medium-term. Reflecting the unexpectedly slow updrift in underlying inflation over the last couple of months, the ECB lowered its inflation projection for 2019 from 1.5% to 1.4% but left the outlook for 2018 and 2020 unchanged. The ECB did not revise its projections for a moderate increase in core inflation to 1.8% in 2020.

**ECB OUTLOOK**

Going forward, we expect the ECB to adjust its guidance and its policy stance in a series of baby steps. If growth and inflation stay on track, the ECB will probably:

- announce on 14 June or 26 July that it will scale back the amount of monthly asset purchases from the current €30bn from October onwards and link its guidance on interest rates more closely to the inflation outlook;
- declare on 13 September that it will purchase assets of €15bn net per month from October onwards until at least the end of December 2018;
- announce on 13 December that asset purchases will indeed end in December 2018, with a chance that the ECB may disclose this on 25 October already;
- raise the refi rate by 25bp in June 2019 coupled with a hike in the deposit rate to 0% and the marginal lending rate to 0.5%;
- increase rates again by 25bp in December 2019, followed by roughly three further such steps in 2020. During the process, the ECB may also widen the corridor between the marginal lending rate and the deposit rate.

To make the rate corridor around the refi rate symmetric again before the first refi rate hike in June 2019, we still see a chance that the ECB may raise the contentious deposit rate from -0.4% to -0.25% in March or April 2019 already.

If core inflation fails to edge up over the course of the year, the ECB may wait even longer before eventually tightening its policy. If growth continues to surprise on the upside while core inflation edges up, the ECB may raise its refi rate as soon as March 2019.

**Table 1: Eurozone real GDP forecasts**

| | 2018 | 2019 | 2020 |
|---|---|---|---|
| ECB (Mar 2018 projections) | 2.4 | 1.9 | 1.7 |
| ECB (Dec 2017 projections) | 2.3 | 1.9 | 1.7 |
| Bloomberg consensus | 2.3 | 1.9 | 1.8 |
| Berenberg | 2.5 | 2.1 | |

*Yoy change in %. Bloomberg consensus taken on 8 March. Source: ECB, Bloomberg, Berenberg*

**Table 2: Eurozone headline inflation forecasts**

| | 2018 | 2019 | 2020 |
|---|---|---|---|
| ECB (Mar 2018 projections) | 1.4 | 1.4 | 1.7 |
| ECB (Dec 2017 projections) | 1.4 | 1.5 | 1.7 |
| Bloomberg consensus | 1.5 | 1.6 | 1.6 |
| Berenberg | 1.5 | 1.7 | |

*Yoy change in %. Bloomberg consensus taken on 8 March. Source: ECB, Bloomberg, Berenberg*

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
holger.schmieding@berenberg.com