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ECB: SAILING SMOOTHLY INTO THE SUMMER BREAK

Berenberg Macro Flash

Steady as she goes: The ECB sailed smoothly into the summer break today. Drawing comfort from the positive market reaction to its dovish tapering decision in June, the ECB today largely confirmed the status quo and reiterated its June messages.

More precisely, the ECB did not change its policy, tweak its guidance, adjust its outlook for growth and inflation or re-assess the balance of risks to its projections in any significant way today. The ECB also did not explain in more detail what its pledge to keep **interest rates** on hold at least "through the summer of 2019" means. Asked about it, ECB president Mario Draghi largely dodged the question while acknowledging the current market pricing. The market sees an 85% chance of a 10bp increase in the deposit rate in Q3 2019 and is only fully pricing in the move by year-end. September seems to be the earliest possible month for a rate hike. According to Draghi, the ECB Council did not discuss its future **reinvestment** policy today, thus not providing any clue as to whether or not the ECB may eventually choose to lengthen the maturity of its bond portfolio as part of a reinvestment strategy.

On the **economic outlook**, Draghi emphasised that not much had changed since June. Noting that economic indicators and survey results are stabilising recently above their historic averages, he reiterated that the economy remains on a "solid and broad-based growth path". In a slight change to the words it had used in June, the ECB noted that the risks to the outlook could "still" be assessed as "broadly balanced". As the ECB added the word "still", this sounds slightly more cautious than previously. Explaining why growth is no longer as exceptionally fast as it was in the last three quarters of 2017, the ECB put more emphasis on external factors, emphasising that export growth in much of 2017 had been exceptionally strong.

The ECB expects underlying **inflation** to creep up gradually towards its target of just below 2%. With a slightly more hawkish tone than before, the ECB noted that "uncertainty around the inflation outlook is receding".

As before, the ECB reiterated that the anticipated end of net asset purchases this year and the promise to keep rates on hold for at least the next 12 months remain subject to the condition that data develop roughly in line with ECB projections. By autumn this year, the ECB may specify its reinvestment policy and in spring next year clarify the first rate hike timing.

To some extent, yesterday's agreement between US President Donald Trump and European Commission President Jean-Claude Juncker and the somewhat lower risk of a US-EU trade war vindicate the ECB's calm policy approach to the noise so far. It also supports the ECB's and our view that, if the negotiations start in earnest and produce a deal eventually, Eurozone business confidence can recover this autumn. This should allow the Eurozone to overcome its current soft patch with a return to annualised growth rates of around 2% from Q4 2018 onwards and throughout 2019, in our view.

In a small nod to the **US-EU ceasefire agreed by Trump and Juncker**, the ECB statement acknowledged that trade tensions "remained prominent" instead of saying that they had become even more so than before. Draghi cautiously welcomed the Juncker-Trump agreement. While emphasising that it was too early to assess the substance of it, he called it a "good sign" and applauded an apparent US "willingness to discuss trade issues in a multilateral framework again". Picking up on Trump's criticism that Europe is engaging in competitive devaluations, Draghi stressed that the ECB abstains from such things, has no target for the exchange rate, and trails behind the Fed in interest rate hikes simply because the Eurozone economy lags behind the US economy in terms of the stage of the cycle.

Policy outlook: We expect the ECB to follow up on its guidance. Short of a major downside surprise in growth and/or inflation, the ECB will end its net asset purchases on schedule in December 2018. We look for the ECB to raise its rates in September 2019, probably with a 25bp increase in the deposit rate from -0.4% to -0.15%, while adjusting its main refinancing rate and its marginal lending rate by 10bp at the same time to 0.1% and 0.35%, respectively. That would restore a symmetrical 25bp corridor around the main refi rate. The move may be followed by a further 15bp increase in all three rates in December 2019 and two 25bp rate hikes in 2020. We are, therefore, slightly more bullish than the market. Of course, if the trade tensions escalate further and/or if underlying inflation fails to edge up over the next 12 months, the ECB may delay its first rate hike beyond September 2019. As a possible risk scenario, the ECB may also decide to raise only the deposit rate in September 2019 and leave the main refi rate unchanged until December next year.

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