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ECB STRESSES RISKS … MORE EXPLICTILY THAN BEFORE

Berenberg Macro Flash

More weight on the risks: ECB Governing Council (GC) members acknowledged that the rise of protectionism, weaknesses in emerging markets and volatile financial markets could weigh on the Eurozone economy more than so far expected. Immediately after the press conference on 13 September we argued that the ECB possibly had been slightly less dovish than many market participants had expected. While the account of the 12-13 September meeting largely echoes the communication from mid September, it stresses more explicitly the downside risks stemming from a more challenging external environment and the possible spillovers to the domestic economy than the press conference did. The stronger cocktail of risks supports our recent further downgrade of Eurozone growth forecasts, with the ECB possibly to follow with its own downgrade in December, but we agree with the ECB that it is not strong enough to change policy.

Snippets from the ECB account:

1. Whereas the account stresses that the risks to the outlook are still "broadly balanced", it reveals that **at least one member remarked that there was also a case for regarding the risks as "tilted to the downside"**.
2. As to the assumption of constant export market shares embedded in the ECB's growth projections published in September, GC members pointed out that could be considered a "**rather benign scenario**".
3. The account points out that while the Eurozone economy had turned "more robust in recent years", heightened uncertainty across the globe could hit the Eurozone more significantly over time if confidence were to drop further.
4. Recalling that "there had now been two consecutive downward corrections to growth" the remark was made that "**some of the factors behind the revisions may not prove entirely transitory**".
5. Whereas the Eurozone had shown "considerable domestic resilience", there could be "**larger spillovers from weaker external demand to domestic demand**" in the form of lower business investment.
6. The GC discussed in greater detail the **impact of protectionist measures on inflation**. The ECB stated that it was **"not clear ex ante"** whether the (negative) supply or demand shock would dominate, or they would offset each other completely.

Confirming earlier positive messages: The account still said that, with none of the major risks having materialised so far, the Eurozone economy would enjoy a "broad-based expansion". Amid the more challenging environment it was noted that "moving away from reliance on external demand towards more domestic sources of expenditure" would increase its robustness. A more robust domestic economy is one of the reasons why growth has held up much better than in previous years during which net exports did the heavy lifting.

Inflation outlook: The account reiterated the ECB's confidence that the current healthy upswing in combination with a continued "significant monetary policy stimulus" would support the sustained convergence of inflation towards the target of "below, but close to 2%". GC members acknowledged the rising wage pressures, but also stressed that they had not translated into a pick-up in prices just yet, in fact the transmission from wages to prices would “remain uncertain and subject to time lags”. It underlines our view, that underlying inflation is likely to edge up only gradually and slower than the ECB’s projections of core inflation (1.4% in 2019 and 1.7% in 2020 versus 1.5% and 1.8%, respectively).

Policy stance: Judging by communication since the 12-13 September meeting, the ECB seems to be sticking to its line that “the current configuration of the monetary policy stance was robust to small changes in the outlook”. This does not necessarily apply for the growth projections which the ECB may have to nudge down further in December. In a less “benign scenario” the ECB may have to revise its 2018 rate of 2.0% to 1.9% or 1.8% which would be in line with our forecasts. Following the cut in net asset purchases from €30bn to €15bn in October, the ECB will end its purchases on schedule at the end of December. After holding rates steady “through the summer of 2019”, we look for the ECB to raise rates in two small steps in late 2019 (September and December).

On **Italy**, the account just mentions ECB board member Benoit Coeure’s report on volatile bond markets, but that spillovers from Italy to the rest of the Eurozone bond markets had been “very limited”.

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