Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

ECB: PROACTIVE AGAIN

Berenberg Macro Flash

The ECB acts proactively and expresses more explicitly than before its determination to go further, if necessary.

Rate guidance pushed out to H1 2020: With its decision to push its guidance to keep rates at current levels "through H1 2020" rather than just "through 2019" as before the ECB sent a dovish message today after its Governing Council meeting in Vilnius, Lithuania. We had expected this step in September. Going into this meeting markets had priced in no rate hike over the next two years and only a 15bps rate hike by mid-2022. A shift to a more dovish stance by the Fed makes rate hikes by the ECB even less likely in the foreseeable future. Amid risks to the Eurozone economy that had "gained in importance and projection" relative to 3 months ago and a slightly downgraded medium-term growth outlook (see Chart), the ECB seemingly preferred to signal sooner than later that it will keep rates low for longer. That the ECB stuck with its previous guidance to keep rates at current levels and did not add "or lower", signals that the ECB is not yet seriously considering rate cuts. Markets had priced in a rate cut of 10bps before the meeting.

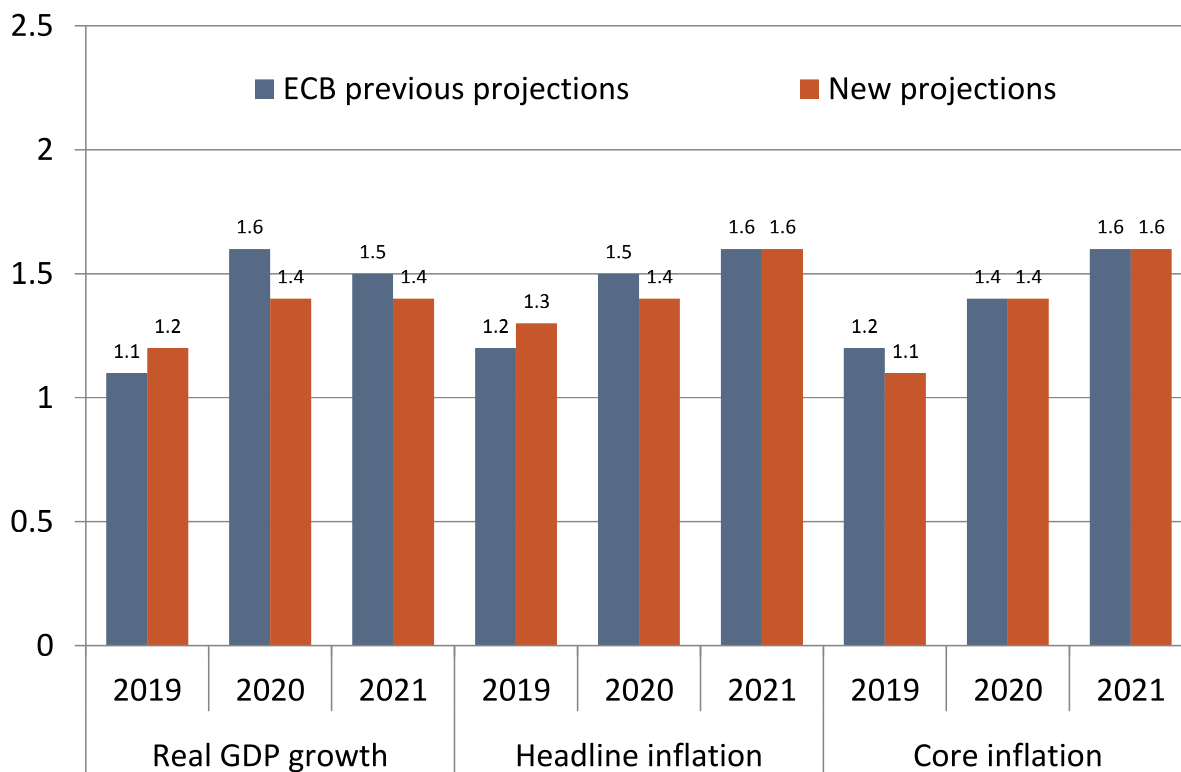
More "granular" discussion about policy toolbox: The ECB also both strengthened and elaborated on its commitment to use all instruments to deliver on its mandate of achieving 2% inflation. It was "determined to act in case of adverse contingencies", the 2% inflation target would really be a "symmetric" one and a more "granular" discussion about all instruments had started, according to ECB President Mario Draghi. Further cuts to the deposit rate and further asset purchases, commonly known an quantitative easing (QE), were among the options discussed. Draghi said that "in the aggregate" across the Eurozone the ECB's negative rate policy had not affected bank profitability in such a way that lending would be hampered. This could, however, come into play at lower rates, when the ECB would probably have to think about mitigating measures. Pointing also to a recent ruling by the European Court of Justice, Draghi said that there would be enough headroom to re-launch QE and the "policy space is there". When discussing the various instruments, he also pointed to the fundamental role fiscal policy could play in an adverse scenario.

30% chance of QE: Draghi did not elaborate on the "adverse contingencies" or when the ECB would use these instruments. Further falls in inflation expectations may be such a trigger. In the past, when markets were worried about a recession risk and inflation expectations had dropped significantly, the ECB announced major easing measures. Draghi stressed that global factors would be at play here and the ECB would not see a "de-anchoring" of inflation expectations from the ECB's target. Indeed, survey-based indicators continue to hold up relatively well at around 1.8% for the long-term. As such, the publication of the next Survey of Professional Forecasters on 26 July will be an interesting one to watch out for. As that will be a day after the next ECB meeting, a potential move in the direction of QE or rate cuts will unlikely come before September. For the time being, we see a 30% chance for the ECB to go in either direction over the next six months

as the economy should regain some traction later this year and inflation expectations should recover.

TLTROs pricing largely in line with expectations: Besides extending its rate guidance and elaborating on its commitment to act if necessary, the ECB announced the terms for its new round of long-term loans (TLTRO-III) – they were largely in line with expectations. For banks that meet the necessary conditions, the rate on such loans can be as low as the deposit rate plus 10bps. At current rates, banks could earn up to 30bps on taking out these loans. The normal rate would be indexed to the refi plus 10bps (see Table). Importantly, as the rate is indexed – rather than fixed – to the main refinancing rate, the terms could even be more generous than the current TLTROs: if rates were to fall before March 2021, also the rates on these TLTRO would fall.

ECB previous projections vs. our estimates of new ECB projections (yoy, in %)



Sources: ECB, Berenberg.

TLTRO-III versus previous two TLTRO rounds

	TLTRO-I	TLTRO-II	TLTRO-III
Date announced	5 June 2014	10 March 2016	7 March 2019
No. of tranches	8	4	7
Period	Sep-2014 until Jun-2016	Jun-2016 until Mar-2017	Sep-2019 until Mar-2021
Maturity	2-4 years	4 years	2 years
Interest rate	Variable rate indexed to refi +10bps, later cut to refi	Fixed rate at 0% and as low as the deposit rate (-0.4%)	Variable rate indexed to refi +10bps and as low as deposit rate +10bps
Total amount	432bn euros	740bn euros	?

Source: ECB, Berenberg