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

ECB FLASH: DRAGHI'S PARTING GIFT

Berenberg Macro Flash

After Mario Draghi's last big meeting, the ECB announced a comprehensive package of measures to combat the economic downturn. Both the cut in the deposit rate and the size of new asset purchases are at the low end of expectations. However, amid doubts whether the ECB would resume net asset purchases at all, the fact that the ECB does so and the comprehensive nature of the package mean that the ECB decision lives up to the expectations which the ECB itself had raised in the past three months.

Following a discussion that probably was more controversial than usual, the ECB today decided to:

- cut the penalty rate on bank deposits at the ECB by 10bp to -0.5% from -0.4%;
- introduce a two-tiered system for the penalty rate to contain the damage to bank balance sheets;
- strengthen its forward guidance on rates (inflation outlook needs to "robustly converge to a level sufficiently close to, but below, 2%"), dropping the previous guidance that rates would remain at their present or lower levels "at least through the first half of 2020";
- re-launch net asset purchases worth €20bn a month until shortly before the first rate hike;
- extend the maturity of its new round of long-term liquidity injections (TLTROs) from 2 to 3 years.

Will the more aggressive ECB stance make a difference? Not much. A series of external shocks, notably the US-Chinese trade war and the Brexit mess, have derailed the Eurozone recovery. Amid such pervasive uncertainty, even lower financing costs for households and companies will not raise consumption and/or business investment significantly. At the margin, the ECB is making it easier for governments to finance the modest fiscal expansion which they are planning anyway. More importantly, the ECB is containing the downside risks. The very accommodative stance of monetary policy makes it unlikely that the economic downturn could spark significant financial turbulence, which in turn could otherwise exacerbate the downturn.

Although Draghi will still chair the ECB's 24 October meeting before leaving office one week later, today's meeting with a new set of staff projections was probably the last occasion for the ECB to take major decisions under Draghi. We do not expect his successor Christine Lagarde to deviate much from the course set by Draghi.

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Joh. Berenberg, Gossler & Co.
KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7889
www.berenberg.com
holger.schmieding@berenberg.com