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ECB ACCOUNT CONFIRMS LAGARDE HAS WORK TO DO

Berenberg Macro Flash

The account of the 12 September Governing Council meeting reflects the serious divisions within the ECB. Four weeks ago, the ECB adopted a comprehensive policy package, including the resumption of net asset purchases. Governing Council members differed on the assessment of the economic outlook, the effectiveness of policy instruments and the scale of the action. At the same time, they showed unity in their demand for fiscal policy to become more active. Some disagreement is normal and can be healthy, but the ECB has to be careful. For ECB policy to be effective, Christine Lagarde will have to calm the debate and bridge the gaps when she starts her new job as ECB President in November.

Below we highlight key points from the account of the 12 September ECB Governing Council meeting:

- **Policy package: all members agree on need to act; "clear majority" supported package**
  - "Although the rationale for a comprehensive package was widely shared, members assessed the case for specific elements differently, with some measures seen as substitutes rather than complements."
  - "It was also cautioned that the Governing Council shouldn't try to accommodate market expectations but should base its decisions on its own assessment."
  - "An argument was put forward that in an environment of high uncertainty, to exceed market expectations might be counterproductive, as this might be viewed as signalling a worse outlook than embraced in the forecasts."
- **Asset purchases: very contentious, at least at this stage; 33% issuer limit unlikely to be raised soon (stronger tilt towards non-government bonds?)**
  - There was a "clear majority" in favour of restarting net asset purchases, but "a number of members" saw the case as "not sufficiently strong, either because they deemed them to be a less efficient instrument, given the prevailing compression of term premia, or because they deemed them to be an instrument of last resort".
  - A remark was made that open-ended net asset purchases could give rise to demands for higher monthly purchase amounts. This would call into question the programme limits, which were considered important to ensure that the boundary between monetary policy and fiscal policy was not blurred.
  - The current "stance of fiscal policy would allow the Governing Council to continue purchases under the current limits for a significant period of time". As a result, the decision was made to "put off the discussion about the constraints of the programme until they became more pressing".
- **Rates: centre of gravity was at 10bps cut; reversal rate not yet reached**
  - A "very large majority" passed the 10bps cut in the deposit rate to a record-low of -0.5%.
  - In combination with the strengthened guidance the rate cut would complement "the effects of net asset purchases on the long end of the curve".
  - The account showed some members were ready to back a 20bps rate cut in exchange for resuming net asset purchases. Others needed to be convinced of a rate cut because of concern about the possibility of increasingly adverse effects.

- **Guidance: broad support for strengthening guidance; a numerical inflation target introduced in 2020 as part of guidance?**
  - "Members generally agreed with the proposal to enhance the state-based component of the Governing Council's forward guidance on interest rates."
  - The proposed forward guidance was seen as crucial "to making the 'lift-off' date for interest rates state-dependent and to anchoring expectations sufficiently far out in the future."
  - "Some initial support was expressed for basing the forward guidance on a quantitative benchmark of both projected and realised inflation in order to provide greater clarity on the inflation aim."
- **Tiering: some "reservations"; two-tier system opens up option for further rate cuts**
  - "A majority of members went along with the proposed introduction of a two-tier system for reserve remuneration."
  - Tiering would also "corroborate the Governing Council's forward guidance that interest rates could be lower than the current levels."
  - "A number of reservations" were expressed. Council members stated that "the transmission channels seemed to be functioning well", "banks would benefit from TLTRO III" and "providing partial relief only to banks for the costs of negative rates raised potential distributional and communication challenges."
- **TLTRO III: "A large majority" agreed to make the terms of the new series of quarterly TLTROs more generous.**
- **Strategy review: "Merit was seen in underlining the symmetry of the Governing Council's inflation aim in qualitative terms, without pre-empting a future review of the ECB's strategy."**

Plurality of opinions within central banks is essential, but so is corporate identity. To grasp the state of the economy and come up with the appropriate policy response, central banks have councils and committees whose members bring potentially very different opinions to the table. But once they have taken a decision, all central bank representatives should focus on jointly explaining the decision to the public more than emphasising the differences. Of course, to communicate dissenting votes is not necessarily counterproductive. The Fed, BoE and other central banks do so. But a central bank can convey its message most effectively if it speaks largely with one voice, in our view. This is especially the case in the context of a supranational currency area of still relatively heterogeneous economies.

The ECB has not spoken with one voice lately. Divisions have become more apparent than before since the ECB Governing Council adopted a comprehensive policy package at its 12 September meeting. A number of national central bank governors have expressed their opposition more forcefully and publicly than before. One ECB executive board member who was against net asset purchases resigned in the days after the September meeting. Last week, a group of former ECB executive board members and governors published a sharp criticism of the ECB's policy stance – something that was rarely done before. The leaked report according to which the monetary policy committee – consisting of staff from the ECB and national central banks – advised against bond purchases, adds to that. That the different factions are airing their differences so publicly after the decision has already been taken – in our view – can limit the efficacy of the ECB's policy measures.

The stakes are high. The ECB has been one of the most effective institutions in Europe in the last two decades. It remains the Eurozone's financial backstop. To do its job as effectively as possible in a challenging global economic environment, it needs to send clear policy signals. Christine Lagarde's most pressing job when she takes over from Mario Draghi as President of the ECB on 1 November will be to bridge the gaps. If she can persuade decision makers to agree on a more balanced policy mix between the monetary, fiscal and structural sphere, she stands a better chance of calming the frosty atmosphere in Frankfurt.

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