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DRAGH-ERA IN FOUR CHARTS

Berenberg Macro Flash

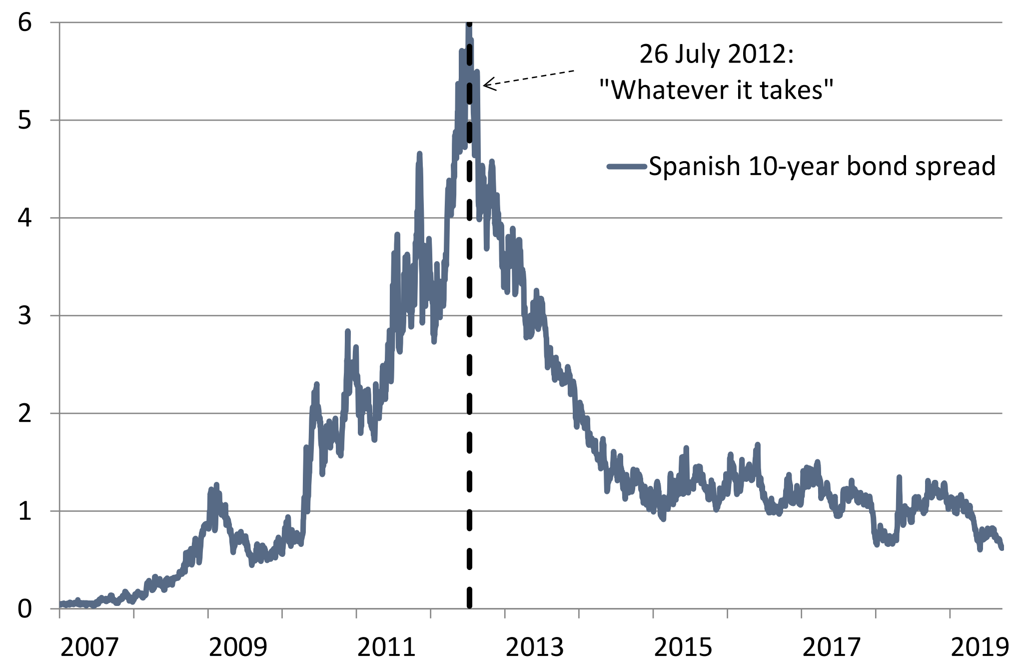
For the last eight years Mario Draghi has been the most closely watched person in global finance, to the extent that traders speculate about ECB policy based on what colour of tie he wears when speaking on monetary policy. Although the Dragh-era is set to end, the era of low rates and the ECB acting as the Eurozone's financial backstop continues. During his presidency the ECB has transformed itself in a major way. Previously unconventional policy measures have become part of the ECB's standard toolkit. This is Draghi's legacy.

As we await Draghi's press conference after the Governing Council decided to hold its policy stance unchanged at its October meeting, we take stock of Draghi's performance in four charts. Mario Draghi's 8-year presidency ends officially on 31 October – effectively it does today.

1. Star performance

With a pledge to do "whatever it takes" in July 2012, Draghi turned the ECB into the de facto lender of last resort for Eurozone governments. This act almost single-handedly ended the euro crisis. After that investors priced in a lower and lower re-denomination risk. Spain and other peripheral countries worst affected by the crisis benefited the most. Chart 1 shows the huge plunge in spreads for Spanish government debt over German debt. Spreads for the other crisis-hit countries followed similar trends.

Chart 1: The impact of "whatever it takes" on bonds spreads

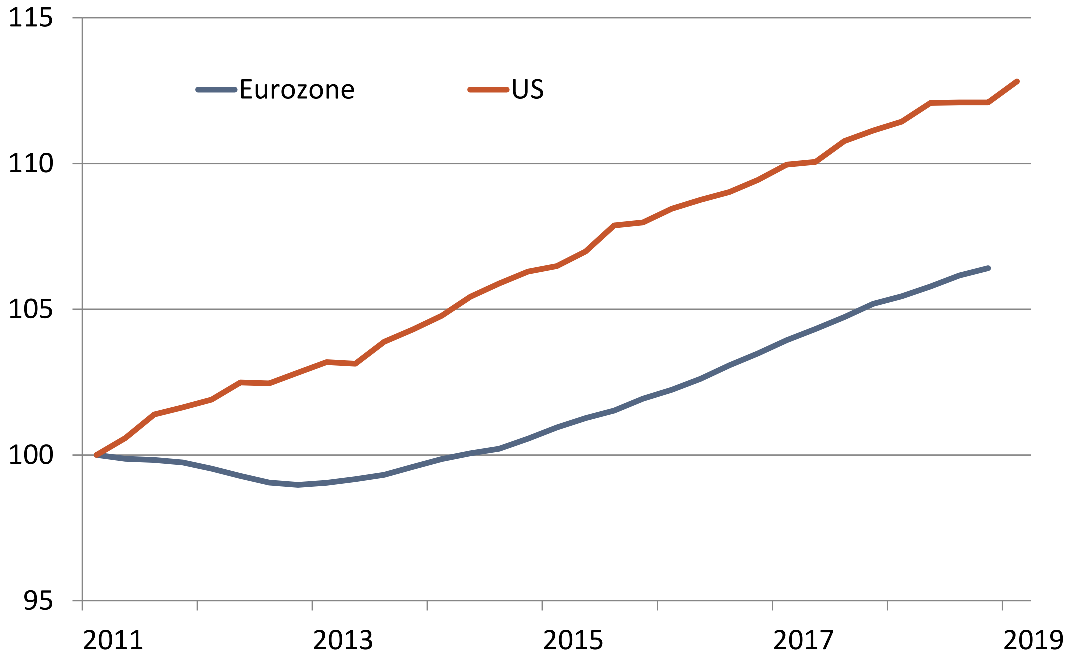


Spread of 10-year Spanish bond yields over 10-year German bond yields, in ppt. Source: Bloomberg, Berenberg

2. Outperformance

The number of jobs in the Eurozone has increased by more than 11m since the low in early 2013. Since 2015 Eurozone employment has grown by 6% matching the rise in the US (see Chart 2). The recovery in jobs stems from the uptick in the business cycle following the double whammy of the financial crisis of 2008/2009 and euro crisis of 2011/2012. We can partly thank the ECB for that. The Draghi-led shift from late 2011 onwards to an ever more expansionary monetary policy stance was more than just a short-term circuit breaker for the Eurozone economy. It provided some lasting support for GDP growth and the labour market.

Chart 2: Jobs growth in tandem with US since 2015

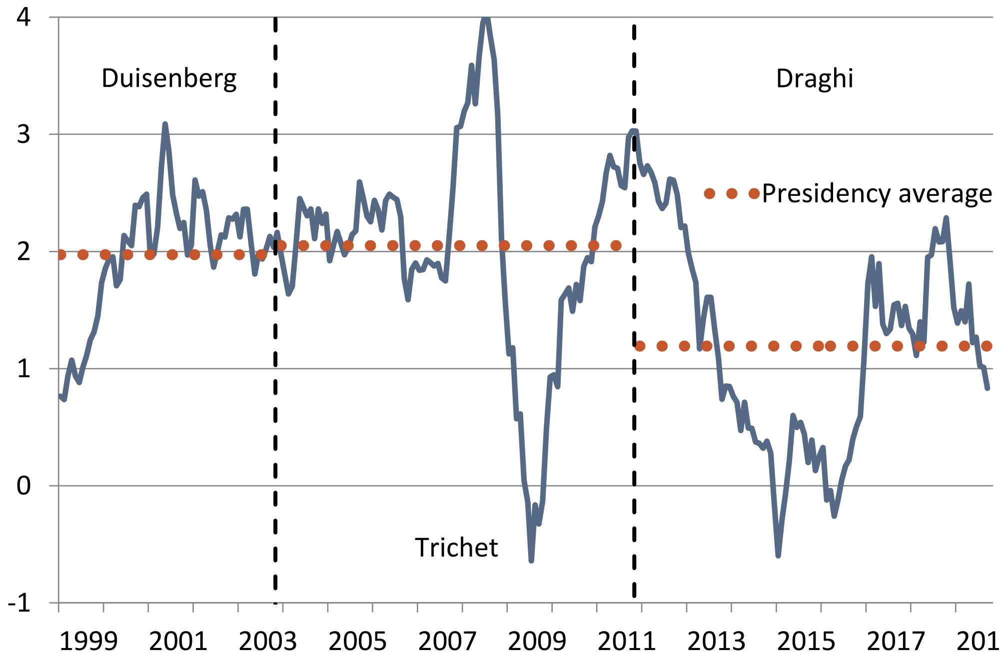


Number of people employed, indexed at 2011Q1=100. Source: Eurostat, BLS, Berenberg

3. Underperformance

In the strictest sense, we should measure ECB presidents against the inflation target of "below, but close to, 2%". Over the period from November 2011 until October 2019 consumer prices rose by 1.2% on average per year (see Chart 3). During the presidency of his two predecessors – Wim Duisenberg from January 1999 until October 2003 and Jean-Claude Trichet from November 2003 until October 2011 – headline inflation averaged at 2% and 2.1%, respectively. Low energy inflation explains part of the difference. But also with respect to core inflation, which excludes energy and other volatile components of the price basket, Duisenberg (1.6%) and Trichet (1.5%) came closer to the ECB's "below but close to 2% target" than Draghi (1.1%). Critically, it is necessary to judge the Draghi era in the context of the problems facing the Eurozone during his reign. The fact that he achieved mostly stable prices and avoided deflation is in itself a huge achievement.

Chart 3: Average headline inflation has been closer to 1% than 2%

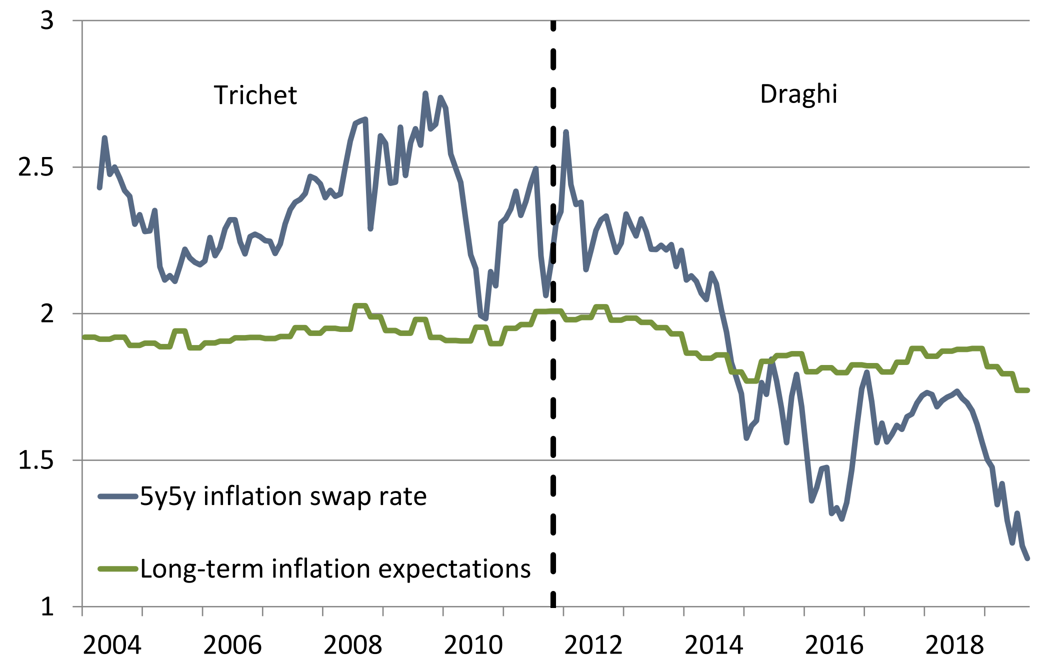


In %. Headline inflation average during Duisenberg presidency was 2%, during Trichet's presidency 2.1%, during Draghi's presidency 1.2%: Source: ECB, Berenberg

4. The risk to watch

Inflation expectations matter. Effectively, forward-looking central banks target expected rather than actual inflation. Monetary policy acts with a lag. During Draghi's 8-year presidency market- and survey-based indicators of inflation expectations have on average remained close to the ECB's target: 1.9% based on the 5-year-5-year inflation swap rate and 1.8% based on the Survey of Professional Forecasters' long-term inflation forecast. But, since Draghi started as ECB President market-based inflation expectations have fallen from 2-2.5% to 1-1.5% and survey-based indicators from 2% to 1.7% (see Chart 4). Taken at face value, they signal that the ECB has become less credible in its pursuit to achieve 2% inflation going forward. Baring an upside surprise in inflation and irrespective of a more growth-friendly fiscal policy, bridging the gap between actual inflation and the ECB's target will require further monetary easing or a more flexible interpretation of the inflation target. The monetary policy strategy review probably finalised by autumn will have to settle this issue.

Chart 4: Long-term inflation expectations have de-anchored from 2%



Monthly data for swap rate. It is an indicator of inflation 5-10 years in the future. Quarterly data for Survey of Professional Forecasters (SPF), in %. Source: Bloomberg, ECB, Berenberg

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