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ECB ACCOUNT: POLICY ON HOLD FOR NOW

Berenberg Macro Flash

The minutes of the 23-24 October Governing Council meeting add to the evidence that the ECB could be largely on hold for the next two years, unless growth and inflation deviate much from our and the ECB's base case that in 2020 things turn slowly to the better. Even though Mario Draghi is no longer President, the long-term forward guidance on steroids ("rates will stay low for a long time") he provided in his last press conference should also apply for the ECB under Christine Lagarde.

Back in October the ECB had kept its monetary policy stance unchanged. The minutes reflect a **Governing Council generally comfortable with the current stance.** "Incoming data … [had] vindicat[ed]" the September decisions to cut the deposit rate by 10bps to -0.5%, resume open-ended net asset purchases of €20bn per month and strengthen the forward guidance.

At the same time, the minutes confirm in line with recent speeches by Governing Council members that the **ECB will likely announce additional stimulus only if the current downturn were to fail to bottom out over the next couple of months** or even deteriorate into a crisis of significant and persistent falls in GDP. The hawkish members of the Governing Council probably bid their tongues at Draghi's farewell party, but have hardly made peace with the resumption of net asset purchases. That "the transmission of the individual measures would take time to work" was a remark made several times in the ECB account: "a plea was made for patience, supporting a "wait and see" posture".

If things were indeed to fail to turn slowly to the better in 2020, in our view, further deposit rate cuts would be the first line of defence. In a more severe downturn and a further de-anchoring of inflation expectations, a higher monthly amount of net asset purchases would come into play.

As the risks to the economic outlook are slightly less tilted to the downside than four weeks ago, **additional stimulus does not seem to be in the cards for the time being.** Back in late October, progress on trade and Brexit had raised hopes for a turnaround in early 2020. Amid still a lot of uncertainty around a US-Chinese mini-deal and the UK's orderly exit out of the EU, a growing number of data (financial indicators, economic surprise indices and business sentiment) has flashed amber instead of red since then.

Still, despite more signs of hope, **the bar to withdraw some of the current stimulus looks equally high** – at least within the next 12 months – amid still elevated downside risks, sluggish growth and muted underlying price pressures. The ECB account pointed out that "there was broad agreement that monetary policy had to remain highly accommodative for an extended period of time."

Of course, a new ECB President bears the risk of a more pronounced policy shift. At a speech tomorrow she could shed a little more light on such a potential shift. And indeed, Christine Lagarde will likely do a lot different. Among other things, she follows a more consensual leadership style when taking decisions. Yet, as long as the economy evolves as the ECB forecasts Lagarde will probably and – thanks to Draghi's September push – can afford to largely keep the current monetary policy stance unchanged until 2021.

As a consequence of a significantly improved inflation outlook and the then probably concluded strategy review, **the ECB could announce at some time in 2021 its intention to phase out the monthly net asset purchases later that year. More likely, the ECB will continue.** We expect underlying price pressures to edge up only gradually. To be able to continue purchases beyond 2021 amid scarcity of some sovereign bonds such as those of Germany and the Netherlands, **the ECB would probably have to eventually raise the 33% limit to buy from each government to 40%.** Depending on the future bond issuance of Eurozone governments and the ECB's tilt towards purchases of non-government debt (corporate bonds, covered bonds and ABS) – or other asset classes, of course – such a decision could come in mid or late 2021.

Until then, managing the strategy review that starts early 2020 will be Lagarde's main task. Getting it right will be crucial to bring the Governing Council together and raise the effectiveness of ECB monetary policy by speaking with one voice again. The ECB account stressed "a strong call was made for unity". As the scepticism towards even more accommodative policy has grown among Governing Council members, we wonder whether the strategy review will include somewhat of a "quid pro quo" for raising the issuer limit. Will the ECB move from "below but close to, 2%" to a target range for inflation of 1.5-2.5%, or perhaps even 1-3%?

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