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ECB PREVIEW: EXCITING FIVE FIRSTS

Berenberg Macro Flash

At the final ECB Governing Council session of 2019 on Thursday, we keep an eye out for five firsts:

1. Christine Lagarde will chair her first monetary policy meeting, followed by her first press conference as ECB president.
2. While the ECB's new president will likely stick closely to the script in her introductory statement, the Q&A session may give markets more colour about what could come during her tenure.
3. The ECB could announce the starting date – likely in early 2020 – of the first review of its monetary policy strategy since 2003.
4. The new ECB staff projections for inflation in 2022 could shape market expectations for the ECB's future exit from its current ultra-loose stance.
5. And a bit of fun, of course. Back in Draghi's day, keen ECB watchers had taken policy cues from the ex-president's tie. Blue tie = dovish? Will Lagarde keep the trend going somehow? Blue scarf perhaps?

On substance, the meeting will likely be a tame affair. Lagarde will likely keep policy on hold unlike Draghi who cut rates at his first meeting as ECB president back in November 2011.

We see no reason for the ECB to adjust its guidance, let alone policy, beyond tweaking its near-term forecasts. The ECB could nudge up its 2019 call for real GDP growth from 1.1% to 1.2% after a better-than-expected Q3 (see Chart 1). Similarly, we expect the ECB to raise its 2020 headline inflation projection from 1% to 1.1%. Inflation has come in a little higher in H2 2019 than the ECB estimated back in September. Oil prices are higher and the euro is slightly lower than three months ago. We expect the ECB to keep its 2021 inflation forecast unchanged at 1.5%. For 2022, we look for the ECB to project an inflation rate of 1.7%. This forecast could be decisive in setting market expectations for the medium-term path of ECB policy. As a rate of 1.7%, or above, is sufficiently close to the ECB's target of "below, but close to, 2%", the ECB Governing Council is likely to emphasise that its current policy stance is consistent with the ECB hitting its target and that no near-term policy changes are on the cards for the time being.

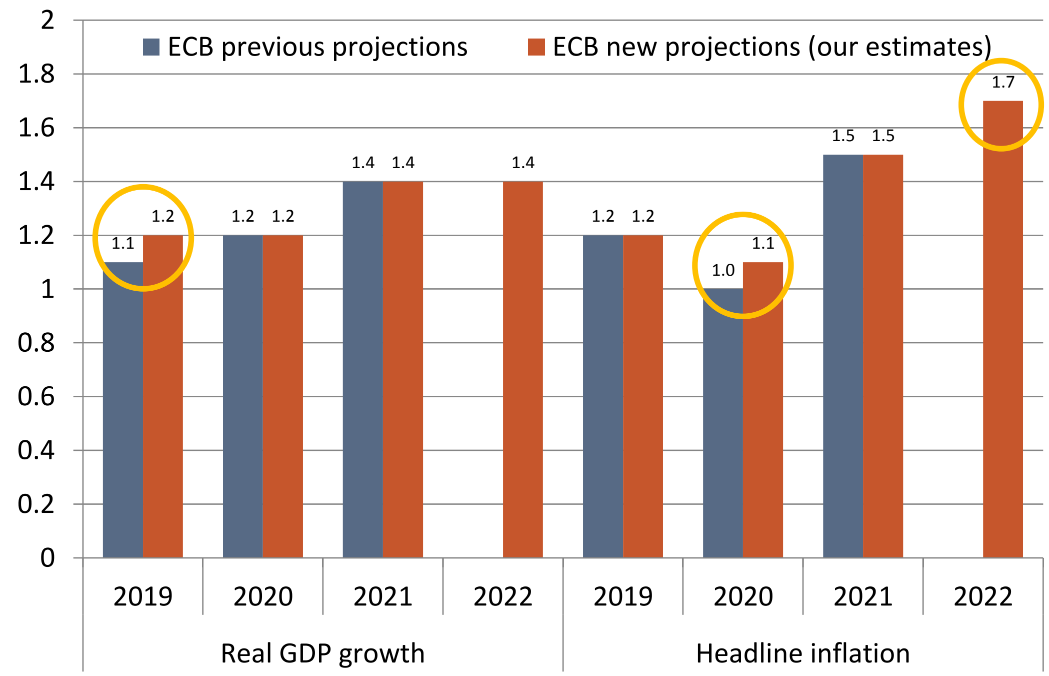
Going forward we expect [the ECB to keep its stance unchanged in 2020] while it reviews its strategy unless growth and/or inflation deviate much from our and the ECB's base case of a gradual improvement in 2020. Probably, the ECB will keep its -0.5% deposit rate, 0% refinancing rate and €20bn monthly net asset purchases on hold until the end of 2021. It may tinker with the factor of minimum reserves it exempts from the -0.5% penalty deposit rate. Currently the factor is 6. The ECB would announce additional stimulus only if the current downturn fails to bottom out over the next couple of months – or, of course, deteriorates further. At the same time, the bar to withdraw some of the current stimulus looks even higher – at least within the next 12 months – amid still elevated downside risks, sluggish growth and muted underlying price pressures.

Of course, the advent of a new ECB President introduces some uncertainty. Lagarde will likely choose to do a few things differently. At first, she will probably strive to rebuild a consensus instead of pushing controversial decisions through the Governing Council – as Draghi tended to do in his last few years as president. As the Governing Council is largely comfortable with the current stance, Lagarde will focus on the strategy review rather than on changing the ECB's guidance or policy. Thanks to Draghi's September push and a slowly improving environment, the ECB need not adjust its monetary policy stance for quite a while.

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 ongoing monthly net asset purchases in that year. In case inflation continues to disappoint to the downside, the ECB may need to extend net asset purchases beyond 2021.** For that however, given the scarcity of some sovereign bonds such as for Germany and the Netherlands, the ECB would probably have to eventually raise the issuer limit from 33% 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 as early as mid 2021.

Watch out for **questions on the strategic review (scope, duration etc.) in the Q&A**, even though at this stage Lagarde's answers will probably not be more specific than her recent ones. At the most, Lagarde might provide a date for the official start of the strategy review (early 2020). That would be something to look forward to! On the side effects of the ECB's policy stance – especially of the negative deposit rate – Lagarde will likely reiterate that the benefits still outweigh the costs.

Chart 1: ECB previous projections vs. our estimates of new ECB projections (yoy, in %)



Sources: ECB, Berenberg.

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