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ECB: DIFFERENT STYLE, BUT NO MAJOR CHANGE YET

Berenberg Macro Flash

No policy changes, no guidance tweaks, no Christmas surprises: At the first Governing Council meeting chaired by Christine Lagarde, the ECB delivered no major surprise. As expected, the ECB kept its highly expansionary monetary policy stance unchanged and did not suggest that it may be contemplating any policy change in the near future. Encouragingly, the ECB detected "some initial signs of stabilisation" and "somewhat less pronounced" downside risks to the growth outlook. As if on cue, US president Donald Trump signalled that US and China could be very close to a "phase one" deal shortly afterwards. Nonetheless, the ECB maintains its easing bias under its new president ("ready to adjust all of its instruments").

Playing it safe: In the press conference, Lagarde very much played it safe today, sticking largely to the script. After reading out the introductory statement, she stressed that comments in her first appearances should not be over-interpreted. Markets have to get used to her, and she needs to get used to the way markets interpret and react to central bank statements.

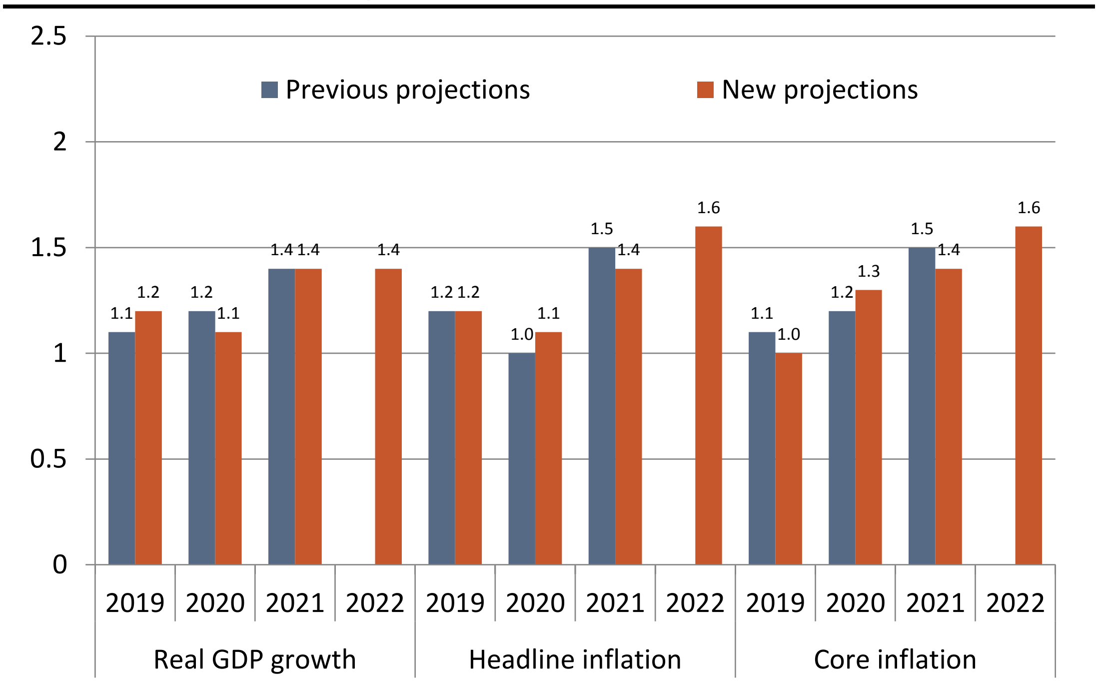
In wait-and-see mode. Back in September, the ECB adopted a comprehensive policy package. The review of its monetary policy strategy is coming up next year. And the economy is evolving broadly in line with the ECB's projections. At least as long as the strategy review takes place – according to Lagarde probably until the end of 2020 – we do not expect the ECB to change its policy stance in any major way. On the side effects of the ECB's policy stance – especially of the negative deposit rate – Lagarde reiterated that the benefits still outweigh the costs. Stressing the negative side effects rather than the determination to act would have been a hawkish move. In our view, the ECB may eventually tinker with the current factor of 6 times minimum reserves for the deposits which it exempts from the -0.5% penalty deposit rate. But that could be it. We do not even expect the ECB to remove the downwards bias for interest rates in 2020.

Is inflation at 1.6% in 2022 a dovish sign? The ECB surprised a little on the downside with a 2022 inflation forecast of 1.6%. Lagarde said that she likes the direction of travel, but admitted that 1.6% for the full year or 1.7% in Q4 2022 would not be fully consistent with the ECB's target. For two reasons, we do not expect the ECB to follow up on that assessment with an even more aggressive policy stance. First, we should not over-interpret the minute details of such projections or her assessment of them. The slightly lower than expected 2022 inflation call is driven by lower energy prices and weaker global price developments and only partly by a lower path for wages and profit margins in the Eurozone. Secondly, moving one year forward, the conclusion of the strategy review may give the ECB more flexibility to be patient – for instance in case the ECB were to adopt a target range from 1.5% to 2.5%.

Outcome hard to predict: The potential impact of the strategy review on monetary policy in 2021 is hard to predict. A symmetric 2% target could potentially delay a first ECB rate hike slightly relative to the current "below, but close to 2%" target. Still, unless growth and/or inflation deviate much from our and the ECB's base case, the ECB will likely keep its -0.5% deposit rate, 0% refinancing rate and €20bn monthly net asset purchases unchanged until the end of 2021. We will probably know only after the conclusion of the strategy review whether projected inflation of 1.6% in 2022 is consistent with the ECB's then updated target.

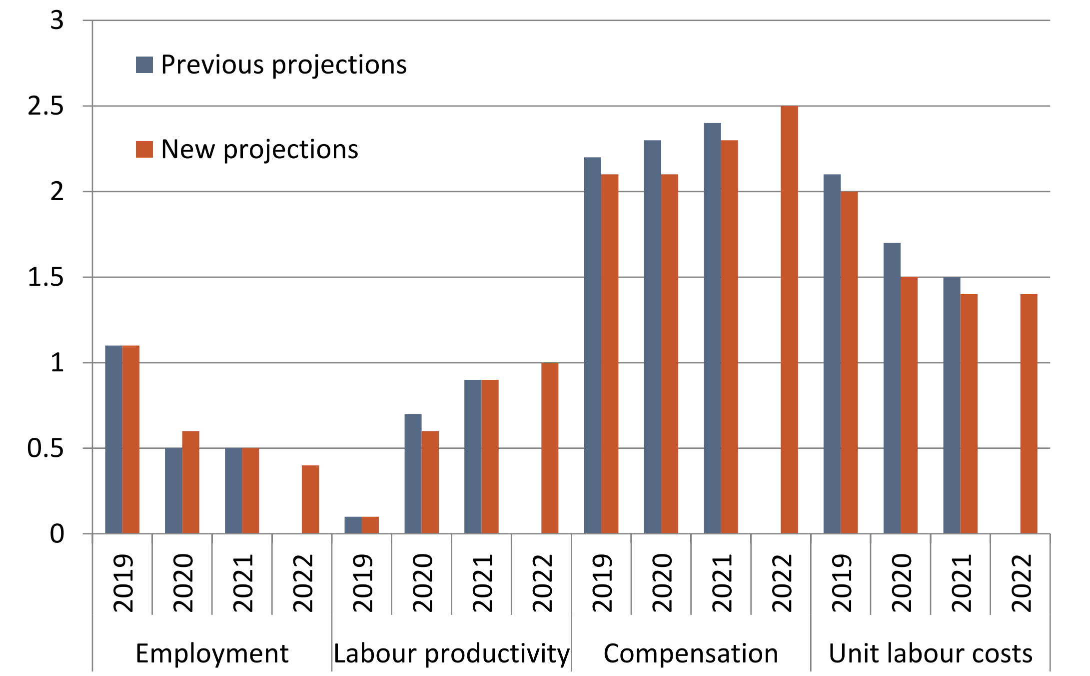
Strategy review: Lagarde revealed that the strategy review would start in January. She said the ECB would leave no stone unturned and would be open minded. In the process the ECB would reach out to the "usual suspects" as well as to parliamentarians, academia and civil society. The ECB would review to what extent it would have to take the technologic process, climate change, income equality into account to better deliver on its mandate. The ECB would also study the "effectiveness and appropriateness" of every single instrument of its toolbox.

Chart 1: Main annual ECB projections (qoq, in %)



Sources: ECB, Berenberg.

Chart 2: Further ECB projections (yoy, in %)



Sources: ECB, Berenberg.

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