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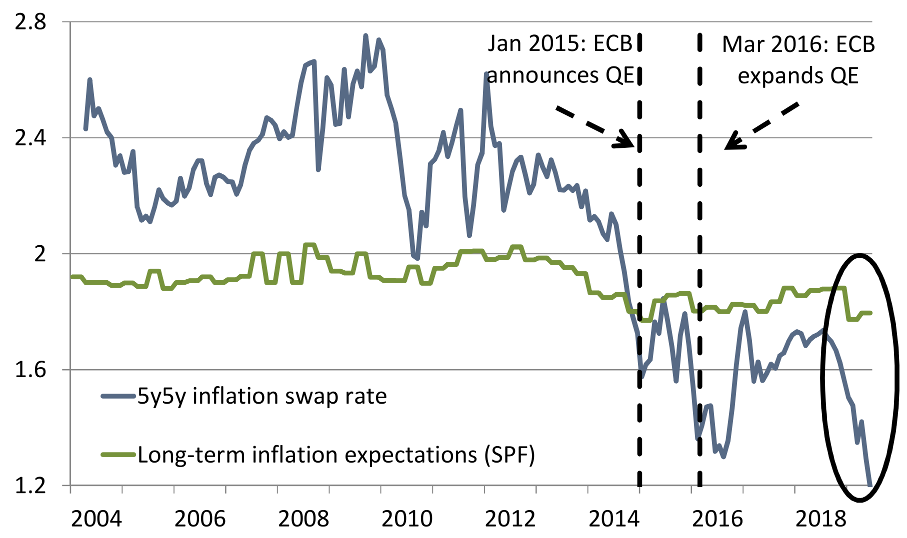
ECB: to QE, or not to QE

- **Growth rebound postponed:** The Eurozone industry is still struggling. While some economic indicators suggest things are stabilising at low levels, a rebound does not look imminent. Downside risks to the outlook have become more elevated. US-China trade tensions have escalated further, the Chinese stimulus is taking time to work its way through the system and the hard Brexit risk has increased. Last week, we nudged down our Eurozone GDP growth calls for H2 2019. Our 2019 call of 1.1% is slightly below the ECB's new projections and consensus of 1.2%.
- **Low inflation for longer:** Weaker growth prospects will keep a lid on how much price pressures can build. Indicators of underlying inflation such as the core rate continue to hover around 1%, a far cry from the ECB's target. Crucially, inflation expectations have fallen (close) to all-time lows (see Chart 1). Taken at face value, they signal that the ECB has become less credible in its pursuit to achieve 2% inflation over the medium term. This has policy implications.
- **Low rates for longer, and possibly more:** Amid weaker growth, low inflation for longer and heightened risks to the outlook of the Eurozone economy, the ECB will keep rates low for longer. Upon slightly nudging down its medium-term GDP growth forecasts last week, the ECB announced generous terms for its new round of long-term loans (TLTRO-III) and pushed its guidance to keep rates at current levels "through H1 2020" rather than just "through 2019". We expect the ECB to hike the refi rate at the end of 2020 at the earliest. A shift to a more dovish stance by the Fed makes rate hikes by the ECB even less likely in the foreseeable future. As the ECB is still expecting a rebound in the economy later this year, it stopped short of any new action. But the ECB expressed more explicitly than before its determination to go further, if necessary.
- **30% chance of QE:** Previous experience suggests that if the economy and inflation expectations head further south, the ECB could relaunch its net asset purchases, known as quantitative easing (QE) (see Chart 1). More negative interest rates, including a tiered system for bank reserves, may be another option to loosen the monetary stance further. Looking ahead, we will pay particular attention to the next edition of the quarterly Survey of Professional Forecasters (SPF) due out on 26 July. Unless the Governing Council members get a preview of the survey at their 25 July meeting, a big policy decision is unlikely to come before September, though. We estimate the chance of the ECB relaunching QE in the next six months at 30%.

Chart 1: Watch inflation expectations



In %. Monthly data for swap rate. For June value, 13 June is taken. Quarterly data for Survey of Professional Forecasters (SPF). Source: Bloomberg, ECB, Berenberg

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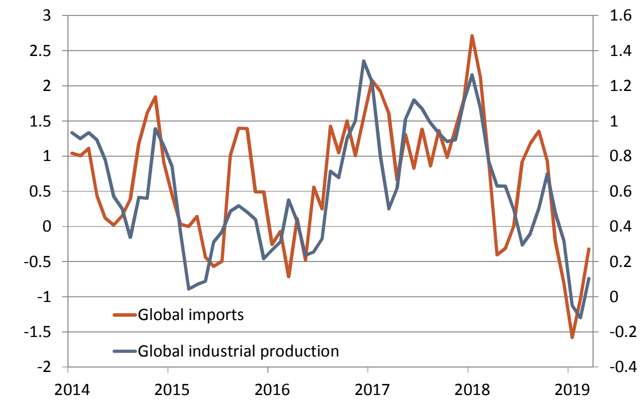
External environment

US President Donald Trump's trade tensions have exacerbated the slowdown in global goods trade and industrial production: both were slowing in 2018 anyway with the cycle maturing and China as the biggest growth driver committed to rein in its domestic credit excesses. Global imports fell in January 2019 by the most since 2009 (-1.6%, see Chart 2). Production followed demand down to a low of -0.1% in February. Investment may be the next to falter if uncertainty about the access to markets – or at what price – grows. Businesses could shy away from expanding their capacities or buying machinery to make their workforce more productive.

Can we take cues from the recent recovery in global import and production? Manufacturing surveys for global PMIs suggest caution (see Chart 3). Chinese PMIs have disappointed in April and May. The stimulus still takes time to work its way through the system. Given its big weight in the overall index, the emerging markets PMI mostly reflects the wobbly Chinese data. PMIs in most developed markets outside the Eurozone (US and Europe ex-Eurozone, among others) have headed further south. South Korean and Taiwanese exports, leading indicators for global trade, have fallen again in May.

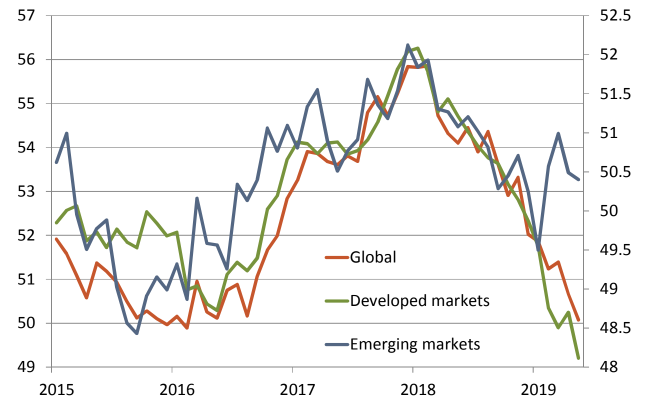
Trump's increased use of tariffs as a weapon to achieve non-economic policy goals adds to the already elevated concerns about growth. A breakthrough on the US-China impasse is unlikely to snap things back to "normal". Meanwhile, while the Chinese stimulus will lift Chinese domestic demand, it will have a lesser impact on global trade. This suggests that the external environment continues to be challenging for the Eurozone.

Chart 2: Challenging external environment – global trade and industrial production are recovering only slowly and …



Change in three-month over three-month average in %. Imports, left-hand scale, production, right-hand scale. Source: CPB

Chart 3: … global manufacturing PMIs point to further weakness



Source: Markit, ISM

Financial conditions

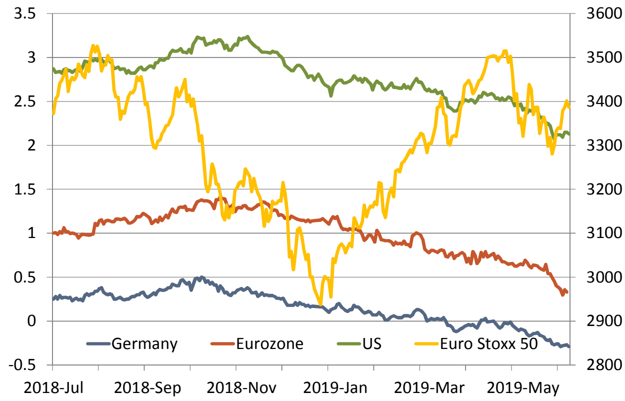
Since the start of Q2, financial markets have responded to continued economic weakness and escalating trade tensions. Investors have largely switched into risk-off mode and are selling equities for bonds (Chart 4). As yields have fallen across the board, the whole curve has flattened. A new all-time low for 10-year German bund yields of -0.26% this week highlights how much investors are rushing into safe havens. Fed Chair Jerome Powell's words that the Fed will act "as appropriate" to sustain economic expansion amid trade tensions along with some potential overselling recently saw stock indices recover last week.

In foreign exchange markets, the euro has devalued vis-à-vis the US dollar and other havens such as the Japanese yen or the Swiss franc as is usually the case in times of financial stress. Gains relative to currencies of emerging markets, suffering even more from the risk-off mode, have more than offset these devaluations, though. In sum, the euro is flat in trade-weighted terms this year, but has appreciated by 1.6% since early April.

Money and credit conditions have eased recently. Looking through the late Easter-driven volatility, both the M1 and private sector credit impulse have picked up on average in March and April versus the turn of the year (Chart 5). Driven by buoyant housing investment, annual growth of bank loans to households continues to edge higher. Credit flows to (non-financial) businesses have also stabilised thanks to long-term flows accelerating, medium-term loans expanding healthily and even cyclical short-term loans bottoming out. It suggests that corporate credit growth could pick up again.

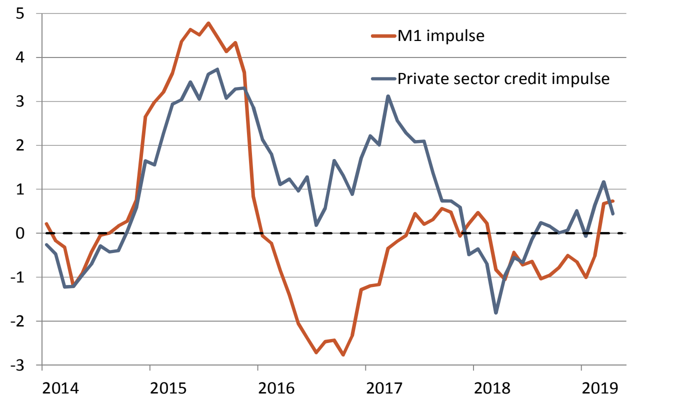
The bank lending survey for Q2 from early April showed that both the low interest rate and investment drive loan demand. Country data reveals the progress is still unevenly spread: Germany, France and most of the smaller Eurozone countries are doing fine, while Italy and Spain still suffer from falling annual private sector credit flows. Unlike Italy, Spain is doing pretty well despite that, however.

Chart 4: Financial conditions mixed – risk-off shift from equities to bonds…



10-year bond yields in %, left-hand scale; Euro Stoxx 50, right-hand scale. Source: Bundesbank, ECB, US Treasury, Stoxx

Chart 5: … but a positive, albeit small, money and credit impulse



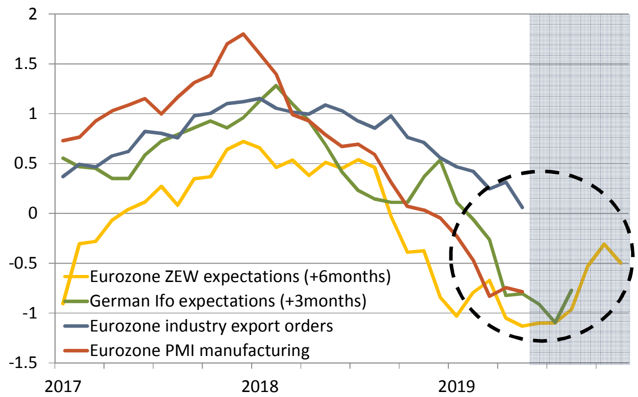
Impulse is the yoy change in the 12-month rolling sum of M1 or private sector credit flows as a % of nominal GDP, in ppt. Source: ECB

Economic activity

A number of positive one-offs boosted real GDP growth to a surprisingly strong 0.4% qoq in Q1. Warm weather drove construction, a late Easter pushed all Easter holidays into Q2, fiscal measures in some countries lifted disposable incomes and catch-up car purchases in Germany helped private consumption. These one-offs will be absent in Q2, and may even reverse while the Eurozone industry continues to struggle. In Q2, the challenging external environment could play out without any offsetting tailwinds. April's 0.5% mom drop in industrial production suggests a weak footing for growth at the start of Q2. We reiterate our call that real GDP growth is likely to be weak at 0.2% qoq.

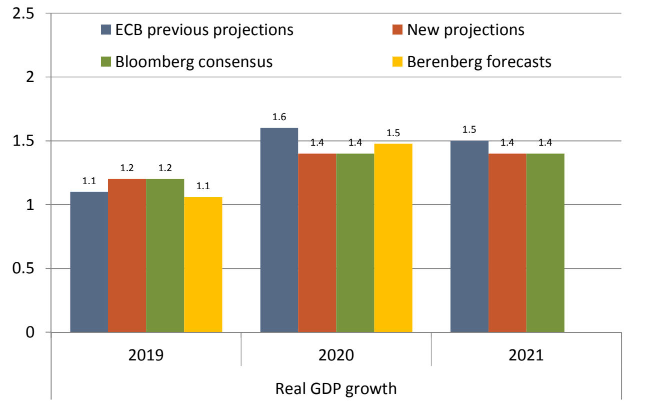
While some economic indicators suggest things are stabilising at low levels, a rebound does not look imminent (see Chart 6). Meanwhile, downside risks to the outlook have become more elevated. US-China trade tensions have escalated further, the Chinese stimulus takes time to work its way through the system and the hard Brexit risk has increased.

Chart 6: Inflection point postponed



Normalised since 2005. ZEW and Ifo expectations advanced by six and three months, respectively. Source: ZEW, Ifo, European Commission, Markit, Berenberg

Chart 7: Downgrade to ECB medium-term growth forecasts



In %. Source: ECB, Berenberg

In sum, the rebound in growth looks unlikely to start before Q4. As a result, we nudged down our Eurozone GDP growth calls for H2 2019 last week. Our 2019 call of 1.1% is slightly below the ECB's new projections and consensus of 1.2%. For 2020, we are above the ECB and consensus (1.5% versus 1.3% – see Chart 7 and Table 1).

Table 1: Eurozone economic forecasts

		2017	2018	2019	2020	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
GDP	% y/y	**2.5**	**1.8**	**1.1**	**1.5**	2.4	2.2	1.6	1.2	1.2	0.9	1.0	1.1	1.2	1.4	1.6	1.7
	% q/q					0.4	0.4	0.1	0.2	0.4	0.2	0.2	0.4	0.4	0.4	0.4	0.4
	%q/q ann.					1.5	1.7	0.6	0.9	1.6	0.6	0.9	1.5	1.7	1.7	1.7	1.7
Private Consumption	% y/y	**1.8**	**1.3**	**1.2**	**1.5**	1.7	1.4	1.0	1.0	1.0	1.1	1.3	1.4	1.4	1.5	1.6	1.6
	% q/q					0.5	0.2	0.1	0.2	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Government Consumption	% y/y	**1.2**	**1.1**	**1.5**	**1.5**	1.1	1.2	0.8	1.2	1.4	1.4	1.7	1.4	1.5	1.5	1.6	1.6
	% q/q					0.1	0.4	0.0	0.7	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Investment	% y/y	**2.9**	**3.3**	**2.9**	**2.6**	3.4	2.8	3.4	3.5	3.9	2.8	2.8	2.1	2.3	2.5	2.7	2.8
	% q/q					0.2	1.6	0.5	1.3	0.5	0.5	0.5	0.6	0.7	0.7	0.7	0.7
Final Domestic Demand [1]	% y/y	**1.8**	**1.6**	**1.6**	**1.7**	1.8	1.6	1.4	1.5	1.6	1.5	1.6	1.5	1.5	1.7	1.8	1.8
	% q/q					0.3	0.5	0.2	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Net Exports [1]	% y/y	**0.8**	**0.1**	**-0.5**	**-0.2**	0.6	0.7	-0.2	-0.5	-0.4	-0.6	-0.3	-0.5	-0.4	-0.2	-0.1	-0.1
	% q/q					-0.2	0.0	-0.4	0.1	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Stockbuilding [1]	% y/y	**-0.1**	**0.1**	**0.0**	**0.0**	0.0	-0.1	0.5	0.1	0.0	0.1	-0.3	0.1	0.0	0.0	0.0	0.0
	% q/q					0.3	-0.1	0.4	-0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account Balance	EUR bn	**361**	**336**	**322**	**316**	98	86	72	80	90	86	69	77	90	86	66	74
	% of GDP	**3.2**	**2.9**	**2.7**	**2.6**												
Industrial Production [2]	% y/y	**2.9**	**0.9**	**-0.6**	**1.1**	3.1	2.3	0.5	-2.1	-0.3	-1.4	-1.0	0.5	0.1	1.4	1.5	1.5
	% q/q					-0.9	0.1	-0.1	-1.2	0.8	-1.0	0.3	0.3	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**9.1**	**8.2**	**7.6**	**7.3**	8.5	8.3	8.0	7.9	7.8	7.6	7.6	7.5	7.5	7.4	7.3	7.2
CPI [2]	% y/y	**1.5**	**1.8**	**1.3**	**1.5**	1.3	1.7	2.1	1.9	1.4	1.4	1.2	1.1	1.3	1.5	1.6	1.7
General Govt. Balance	% of GDP	**-1.0**	**-0.5**	**-1.1**	**-0.9**												
General Govt. Debt	% of GDP	**87.1**	**85.1**	**84.3**	**82.7**												
ECB main refinancing rate [3]	%	**0.00**	**0.00**	**0.00**	**0.25**	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25

[1] Contribution to GDP growth [2] Period averages [3] End of period

Source: Eurostat, Berenberg

Despite significant risks, our base case remains that the economy regains traction later this year, mainly for two reasons: Firstly, the reprieve of tariffs on car imports suggests the US may deal with the EU in a different way than with China and Mexico. Chances are that industry turns up slowly. Secondly, as businesses grow used to the constant noise of trade tensions and the fear factor fades, sentiment can recover eventually.

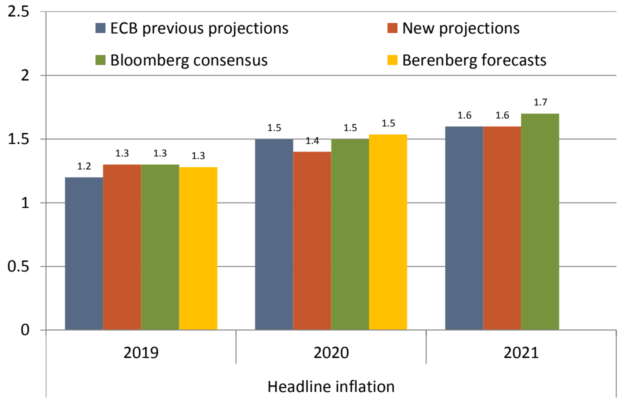
Inflation

The late Easter in 2019 has made the yoy inflation rate volatile since March. Spending on expensive package holidays was lower in March, higher in April and again lower in May. Both the headline and core rate were affected through a volatile contribution from services (0.5ppt in March and May versus 0.9ppt in April).

Higher energy prices supported the headline rate in March (1.4% yoy) and added to the services price boost in April (1.7%). In May, pump prices were up by less than in May 2018 and, therefore, could not offset the unwinding of the Easter travel-related boost to services inflation. The headline rate came in at 1.2%, surprising on the downside. If oil prices evolve in line with currently stable future prices, energy base effects will pull inflation lower, possibly to 1% in Q4.

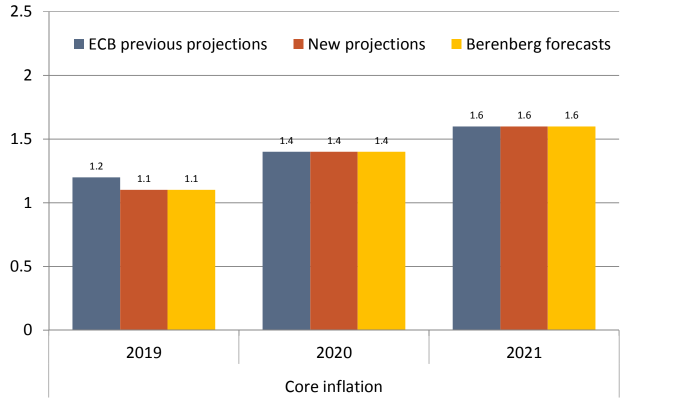
After the negative surprise in May and reflecting lower oil prices, we have taken down our 2019 headline inflation call from 1.4% to 1.3%, but keep our 2020 call at 1.5%. This is largely in line with the ECB and consensus (see Chart 8). The ECB itself raised its 2019 call last week from 1.2% to 1.3% to the higher-than-expected inflation in Q1 and April (1.3% instead of 1.2%). The cut-off date for the ECB's forecast was a few weeks ago and the surprisingly low May inflation data probably did not feed into the June round of forecasts. The ECB lowered its call for 2020 from 1.5% to 1.4%, while it left its 2021 forecast untouched at 1.6%.

Chart 8: No big changes to headline inflation...



Source: ECB, Bloomberg, Berenberg

Chart 9: ... and core inflation forecasts



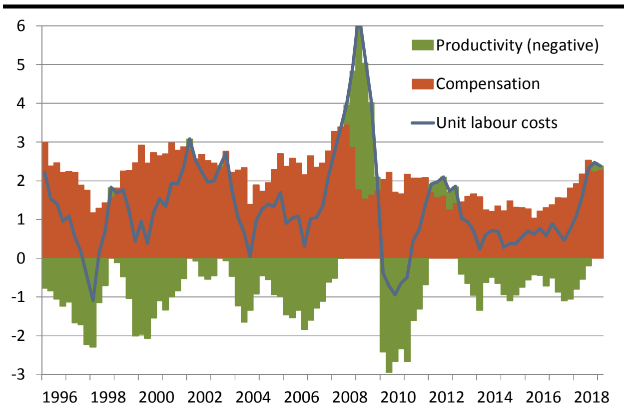
Source: ECB, Bloomberg, Berenberg

The ECB nudged down its 2019 core inflation call from 1.2% down to 1.1%, but left its 2020 and 2021 forecasts unchanged at 1.4% and 1.6%, respectively. They are in line with our forecasts (see Chart 9).

The tightening labour market continues to drive stronger wage gains. Negotiated wages picked up from 2.15% yoy in Q4 2018 to 2.24% in Q1 2019. Prices for recreation and personal care (excluding package holidays and accommodation), where labour represents a big part of input costs, have risen from 1.3% yoy at the end of 2016 to c2% recently. Meanwhile, as productivity growth has dropped sharply, turning negative in Q4 2018 and Q1 2019, unit labour costs have risen from 0.5% yoy in Q3 2017 to c2.5% in Q1 2019 (see Chart 10). So far, businesses have shied away from raising prices much and, as import prices have remained relatively unchanged, margins have come down. As firms cannot lower margins much further, and higher (labour) costs continue to rise, inflation should eventually go up.

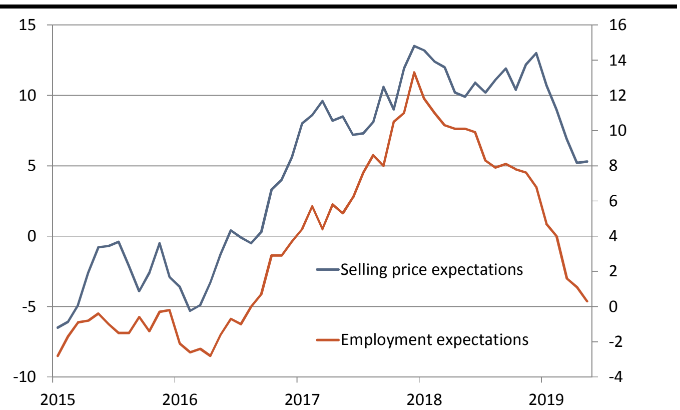
However, underlying price pressures are unlikely to build quickly. History tells a lesson: over and over again we, the ECB and consensus have had to lower our calls for underlying price pressures as core inflation remained extremely sticky around 1% for the past five years. Also, amid heightened risks and weaker demand, manufacturers' labour demand and selling price expectations have come down (see Chart 11). Softer growth prospects will keep a lid on how much price pressures can build. Businesses will probably continue to allow their margins to be squeezed, instead of raising prices by as much as costs are rising. At this stage, we do not expect businesses to curb jobs, but rather to try to keep a lid on pay cheques.

Chart 10: Strong wage gains and a collapse in productivity growth have pushed up unit labour costs...



Source: ECB, Berenberg

Chart 11: ... but manufacturers' expectations for selling prices and labour demand have come down



Selling price expectations, left-hand scale, employment expectations, right-hand scale. Both for industry. Source: Eurostat, ECB

First refi rate hike in Q4 2020 at the earliest

Weaker growth, low inflation for longer and heightened risks to the outlook have a policy implication: the ECB will keep rates low for longer.

Last week, the ECB changed its guidance to keep rates at current levels to "through H1 2020" from "through 2019". We expect the ECB to hike its refi rate in Q4 2020 at the earliest. A shift to a more dovish stance by the Fed makes rate hikes by the ECB even less likely in the foreseeable future.

Besides extending its rate guidance, the ECB also announced the terms for its new round of long-term loans (TLTRO-III). For banks that meet the necessary conditions, the rate on such loans can be as low as the deposit rate plus 10bp. At current rates, banks can earn up to 30bp on taking out these loans. The normal rate will be indexed to the refi plus 10bp (see Table 2). Importantly, as the rate is indexed – rather than fixed – to the refi rate, the terms could even be more generous than the current TLTROs: if rates were to fall before March 2021, the rates on these TLTROs would also fall.

Table 2: TLTRO-III versus previous two TLTRO rounds

	TLTRO-I	TLTRO-II	TLTRO-III
Date announced	5 June 2014	10 March 2016	7 March 2019
No. of tranches	8	4	7
Period	September 2014 until June 2016	June 2016 until March 2017	September 2019 until March 2021
Maturity	2-4 years	4 years	2 years
Interest rate	Variable rate indexed to refi +10bp, and later cut to refi	Fixed rate of 0% and as low as -0.4%	Variable rate indexed to refi +10bp and as low as deposit rate +10bp
Total amount	€432bn	€740bn	?

Source: Eurostat, Berenberg

Inflation expectations

Central banks' bread and butter is as much about targeting (actual) inflation as it is about anchoring inflation expectations. Because monetary policy works with a lag, inflation-targeting central banks effectively target expected rather than actual inflation.

If inflation expectations become de-anchored (ie move ever further away from their target), central banks lose credibility with respect to their mandate. The ECB's mandate is to achieve a year-on-year increase in consumer prices across the Eurozone of below, but close to, 2% over the medium term.

Market-based indicators of long-term Eurozone inflation expectations – such as the five-year/five-year Eurozone swap rate – are down from 1.71% in November 2018 to an all-time low of 1.19%. Breakeven rates for Germany, France and other Eurozone countries are also at or close to their all-time lows. Taken at face value, market-based measures of inflation expectations suggest the ECB is losing ever more credibility with respect to its mandate.

Survey-based indicators have held up better. Long-term inflation expectations stood at 1.795% in Q2, according to the Survey of Professional Forecasters (SPF) published in early April. While they have fallen from 1.88% in Q4 2018, they are actually up from 1.773% in Q1 2019.

That survey-based indicators of inflation expectations have held up better than market-based measures has so far prevented the ECB from taking more action. Besides blaming global factors, the ECB has largely explained the fall in market-based indicators of inflation as being by a more negative inflation risk premium, instead of a genuine rise in actual inflation expectations. According to the ECB, investors have started to treat inflation swaps as deflation hedges instead of inflation bets previously (in Charts 12 and 13 we approximate the inflation risk premium in a model-free approach as the difference between the swap rate and the survey inflation forecast for concurrent maturities).

Yes, the inflation risk premium is more negative, but actual (survey-based) inflation expectations have also fallen considerably close to their all-time lows (1.77% in Q1 2015) and chances are that they follow actual inflation and market-based measures of inflation expectations lower. Governing Council member Benoît Cœuré recently noted that survey-based indicators of inflation expectations had become more closely linked to actual inflation.

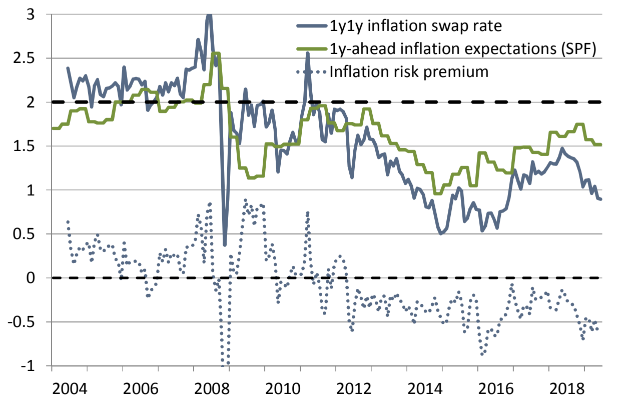
Interestingly, in January 2015, when the five-year/five-year Eurozone swap rate fell to 1.48% and survey-based indicators dropped for the first time below 1.8%, the ECB decided to start purchasing assets worth €60bn a month, known as quantitative easing (QE). In his press conference at that time, ECB President Mario Draghi said that "there is little doubt... that one should act". In March 2016, also after continued drops in both market- and survey-based indicators of inflation expectations, the ECB announced to expand its monthly net asset purchases from €60bn to €80bn.

Last week, the ECB only opened the door for to QE relaunch. Mr Draghi pointed out that the discussion had become "more granular" and that "members raised the possibility of restarting the asset purchase programme".

Despite inflation expectations falling (close) to all-time lows, the ECB has stopped short of any QE action so far, probably for the following two reasons.

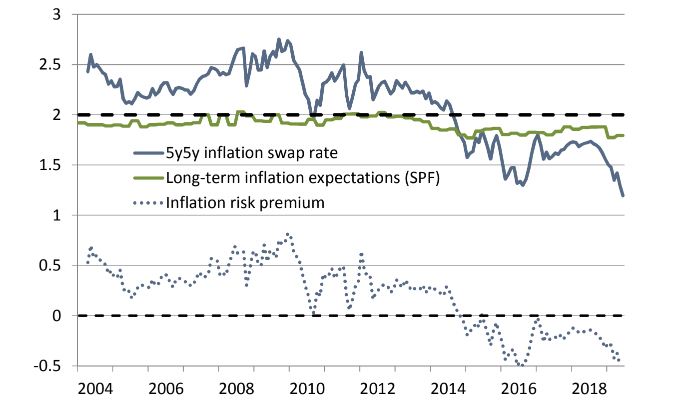
- First, the economic conditions are different. Just before the QE announcements in January 2015 and March 2016, markets were worried about a recession risk beyond the sizeable drop in inflation expectations. We and the ECB, however, do not currently expect a recession, but are forecasting instead that the economy regains traction later this year. A return to growth later this year should restrain further near-term joblessness increases and support continued employment gains. That should allow price pressures to build, and inflation expectations to rise eventually, too.
- Second, the bar to resume QE is high for the ECB, given the technical constraints and political contention. As a result, economic conditions will have to become much worse before drops in inflation expectations will push the ECB to relaunch QE or, say, cut rates further.

Chart 12: Inflation expectations have fallen, for both the short-to-medium term…



In %. Monthly data for swap rate. For June value, 13 June is taken. Quarterly data for Survey of Professional Forecasters (SPF). Source: Bloomberg, ECB, Berenberg

Chart 13: … and for the long term, not only due to a more negative inflation risk premium



In %. Monthly data for swap rate. For June value, 13 June is taken. Quarterly data for Survey of Professional Forecasters (SPF). Source: Bloomberg, ECB, Berenberg

What if?

As of now, the ECB does not have to go beyond comparatively "homeopathic" measures such as an extension to its forward rate guidance and a new round of long-term funding at generous terms. Domestic demand still supports the economy. We expect some external risks to fade and growth to rebound later this year despite the heightened risks. If we are right, inflation expectations should recover.

What if that base case does not materialise, though?

Demographics, global competition, and technological change are keeping actual and expected inflation structurally low. These long-term developments affect the supply side of the economy, which central banks around the globe cannot do much about. If inflation declines because of a demand-side shock, as is currently the case, this is usually different. Trade tensions and the prospect of a hard Brexit have caused a plunge in sentiment. Weaker Chinese demand and country-specific shocks have added to the challenges for the Eurozone over the past 12 months.

If the economy and inflation expectations head further south, the ECB could be forced to make a major turn. The publication of the next Survey of Professional Forecasters on 26 July could be of crucial importance. Unless the Governing Council members get a preview of the survey at their 25 July meeting, a big policy decision is unlikely to come before the 12 September meeting, though. A drop in long-term inflation expectations from the current 1.795% by, say, 10bp as in Q1 2019, to below 1.7% for the first time ever would probably trigger a big move by the ECB.

The ECB's toolbox

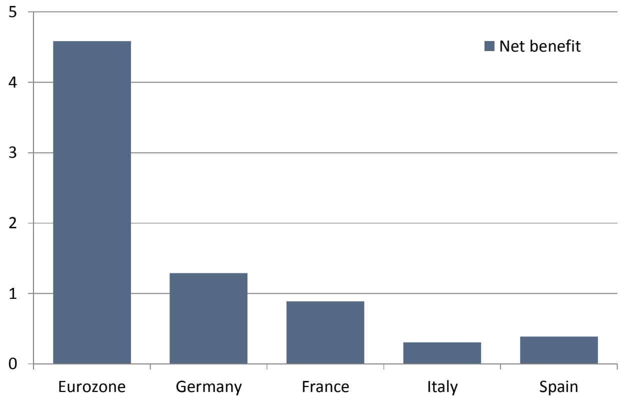
Last Thursday, the ECB repeated its core message that it stood ready to use all of its instruments, if push came to shove. Like other central banks that struggle to achieve their price stability target or risk missing it by an even wider margin, the ECB has to credibly signal that it could do more, and then live up to that signal. The question often arises, though, how much more fuel there is in the tank.

Asked differently, what is left in the ECB's toolbox?

Even more negative interest rates could be an option: "Several members raised the possibility of further rate cuts" at the Governing Council meeting last week. The ECB would then probably introduce a tiered system for bank reserves to alleviate the negative side effects of a lower deposit rate on bank profitability. Applying its negative interest rate of 0.4% only to deposits which exceed, say, 10x the minimum reserve amount would provide a net gain of €4.5bn to Eurozone banks, with German and French banks benefitting in particular (see Chart 14).

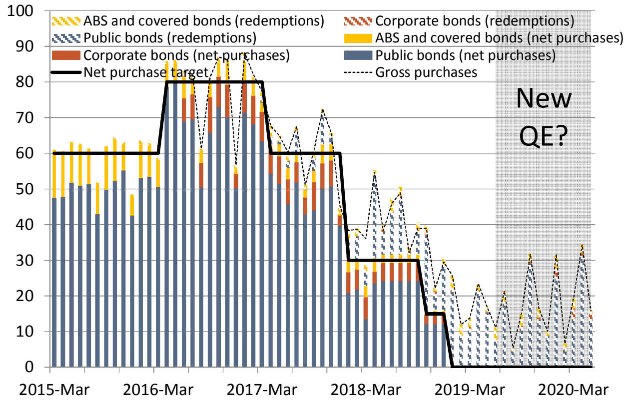
The ECB may restart its asset purchase programme of quantitative easing (QE). It stopped net asset purchases in January 2019 (see Chart 15). In January 2015 and March 2016, when markets were worried about a recession and inflation expectations had dropped significantly, the ECB announced the start and expansion of QE respectively. We see a 30% probability that the ECB will relaunch QE over the next six months.

Chart 14: Net benefit from excluding 10x the amount of (current) minimum reserves from negative interest rate



Source: ECB, national central banks, Berenberg

Chart 15: Timeline of asset purchases



Source: ECB, national central banks, Berenberg

For some government bonds, first and foremost German bonds, the ECB is close to the 33% issuer/issuance limit that it set itself. This restricts the potential for purchases of government bonds. The ECB could, of course, remove the 33% issuer/issuance limit. In September 2015, it had already raised the limit previously from 25% to 33% "subject to a case-by-case verification that it would not create a situation whereby the Eurosystem would have a blocking minority for the purposes of collective action clauses in which case the issue share limit would remain at 25%". For EU supranational bonds the limit is already 50%. For national government bonds, the ECB has set a limit of 33%, however, to "safeguard market functioning and price formation as well as to mitigate the risk of the ECB becoming a dominant creditor of euro area governments". The risk of being the even more dominant creditor if the limit was set at 50% would have significant repercussions. What if a Eurozone member state risked defaulting on its debt? The ECB would face serious potential conflicts of interests.

A change to the capital key rule by which the ECB allocates its asset purchases according to every national central bank's capital share at the ECB would also be highly contentious. Buying more Italian and fewer Dutch and German bonds could cause an uproar north of the Alps. It would also violate the rule that the ECB should run the same monetary policy for all member states.

Instead, buying more (non-bank) corporate bonds looks like the most feasible option. As of the end of May, the ECB had bought corporate bonds worth €180bn out of a total amount of tradable corporate bonds of €1.53trn, ie 11.6% (see Table 3).

The ECB could also increase its purchases of covered bonds and ABS. So far, it has bought €270bn out of a total of €1.48trn in tradable covered bonds (18.1%). Out of €593bn in tradable ABS, the ECB has purchased €26bn, or 4.4%.

A potential that the ECB has not yet tapped is unsecured bank debt with a market value of €1.6trn currently. So far, the ECB has excluded banks because, unlike NFCs, they have already access to cheap funding via TLTROs. The ECB also wanted to promote a shift from bank-based to market-based funding.

Table 3: Purchasable assets versus assets purchased

Asset type	Purchasable assets (March 2019)	Assets purchased (May 2019)	Share assets purchased/ purchasable assets
Government bonds Regional bodies	7,314.6 453.0	1,926.8 (PSPP without Supras + SMP)	24.8%
Unsecured bank bonds	1,619.5	-	-
Covered bonds	1,484.8	269.0 (CBPP 1-3)	18.1%
Corporate bonds	1,527.9	177.7 (CSPP)	11.6%
ABS	593.2	26.3 (ABSPP)	4.4%
Other tradable assets	872.7	229.1 (Supras)	26.3%
All tradable assets	**13,865.7**	**2,628.9**	**19.0%**

In €bn. Source: ECB, Bloomberg, Berenberg

Investing in exchange-traded funds like the Bank of Japan does could also be an option. In our view, buying bundles of equities could be slightly less politically contentious than loosening the self-imposed 33% limits, changing the capital key rule or buying bank debt. While opening up a vast potential, it would not discriminate between member states.

Of course, all of these instruments are either highly controversial and/or technically difficult. Most of them are both. But if push came to shove, and especially in the absence of a major fiscal stimulus that could counteract an economic downturn, the ECB would have to break some old taboos and use new tools to further loosen its monetary stance.

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