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ECB: doing whatever it can

Bond purchases: Potential firepower for ECB if it raised issuer limit from 33% to 50%

duration (in months) \ monthly purchases (in bn euros)	15	25	35	45	55	65	75
12	180	300	420	540	660	780	900
18	270	450	630	810	990	1170	1350
24	360	600	840	1080	1320	1560	1800
30	450	750	1050	1350	1650	1950	2250
36	540	900	1260	1620	1980	2340	2700
42	630	1050	1470	1890	2310	2730	3150
48	720	1200	1680	2160	2640	3120	3600

Raising the issuer limit from 33% to 50% would open up c€1.1trn euros of government bonds for a new ECB purchase programme. Green (red) shaded combinations are (not) possible in that case. Numbers show total amount of a new purchase programme in €bn. Sources: Bloomberg, ECB, Berenberg

- **ECB to the rescue:** Judging by Mario Draghi's Sintra speech, the European Central Bank (ECB) stands ready to add further monetary stimulus if growth and inflation show an "absence of improvement". We now expect the ECB to cut its deposit rate by 10bp and to announce a new asset purchase programme at its 12 September meeting.
- **Risks to growth:** ECB projections for growth of 0.2%, 0.3% and 0.4% qoq in Q2, Q3 and Q4 exceed our own forecasts of 0.1%, 0.2% and 0.4% respectively. Risks to our calls are tilted to the downside. Following the mixed survey results since the ECB meeting (ie German Ifo, PMIs, ZEW, French production outlook), the probability that growth could be in line with ECB projections rather than our below-consensus calls has receded further. Eurostat publishes industrial production data for May on 12 July and a flash estimate of Q2 GDP on 30 July.
- **Low inflation:** Underlying inflation also looks set to undershoot ECB forecasts. To hit the ECB's projected 1.1% average for core inflation in 2019, the yoy rate would have to rise steadily from 0.8% in May to at least 1.3% in December. Since the core rate has been sticky at c1% over the past five years, this looks unlikely amid the current slowdown in demand growth. The next data point to watch is the June flash estimate due this Friday.
- **Rate cuts are the first line of defence:** If growth and inflation fall short of projections, the ECB will likely adjust its guidance in July and vow to keep rates at "present or lower" rather than just at "present" levels. In September, the ECB could follow with a cut to its deposit rate from -0.4% to -0.5%. If inflation expectations drop visibly in the next Survey of Professional Forecasters due in late July, the ECB may even deliver a rate cut on 25 July already. If and when the ECB lowers the deposit rate, the ECB would likely introduce a tiering system for bank reserves to ease the pain for banks. Only deposits in excess of, say, 10 times the required reserves would be charged the penalty rate.
- **Quantitative easing (QE) as the second line of defence:** When growth and inflation expectations headed south in the past, the ECB started and expanded QE. We now see a 60% chance that the ECB will announce new net asset purchases in September with actual purchases starting in Q4 (up from 30%). If the ECB lifted its self-imposed 33% issuer limit to 50%, it could make new net purchases of up c€1.1trn before it would face a shortage of German paper. The green fields in the Table show the possible combinations of monthly government bond purchases and the potential maximum duration of such purchases. The ECB could start with buying €35bn in government bonds for 12 months. Adding €5bn in corporate bonds, total monthly purchases could amount to €40bn.
- **Will it work?** US experience with re-launching asset purchases has been mixed. But in the absence of a big fiscal stimulus and amid very low core inflation, ECB doves believe it is worth trying. In tone, Mr Draghi's Sintra speech resembled his 2012 "whatever it takes" speech in London. He seems determined to do whatever he can.

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