Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

# ECB ON HOLD THROUGHOUT 2020

## Berenberg Macro Flash

While the account of the 11-12 December meeting of the ECB Governing Council – the first presided by Christine Lagarde – supports our call that the ECB will remain on hold throughout 2020, the planned review of its monetary policy strategy will keep the central bank busy for the next 12 months. The account did not offer more detail on the review.

**Fully appropriate stance:** Last September the ECB deployed a comprehensive policy package of asset purchases and a cut to the deposit rate in an effort to lift Eurozone demand growth and inflation. Since then, the economy has evolved broadly in line with the ECB's projections. The account of the December policy meeting noted "some initial signs of stabilisation in the growth slowdown", "somewhat less pronounced" downside risks and "some indications of a slight increase in measures of underlying inflation". As a consequence, the ECB judged its policy stance as "fully appropriate".

**Wait and see:** The review of its monetary policy strategy will begin soon and be likely concluded by late 2020. Growth and/or inflation would have to deviate a lot from the ECB's base case (see Chart 1) for the bank to change its current policy setting: -0.5% deposit rate, 0% refinancing rate and €20bn monthly net asset purchases. The account stressed that "a steady hand being warranted" and "measures should be given time to exert their full impact".

**Side effects:** The account called for "vigilance on the efficacy of the policy measures and the appropriateness of the monetary policy stance" and the need "to be attentive to the possible side effects" with some concern voiced regarding the "potential impact of negative interest rates on euro area households, with savings and consumption dynamics also requiring close monitoring". The account, however, stressed that "faced with a subdued inflation outlook ... a highly accommodative monetary stance for a prolonger period of time" was still warranted. According to the ECB "policy rates had not yet reached the so-called reversal rate" as credit conditions had continued to improve. In addition, "macroprudential policies were the first line of defence for addressing risks and side effects" and "the two-tier system for excess reserve remuneration" could be adequately addressed.

**Possible policy tweaks in 2020:** In our view, if economic conditions continue to improve in line with expectations, the ECB may eventually tweak its stance in two ways in 2020:

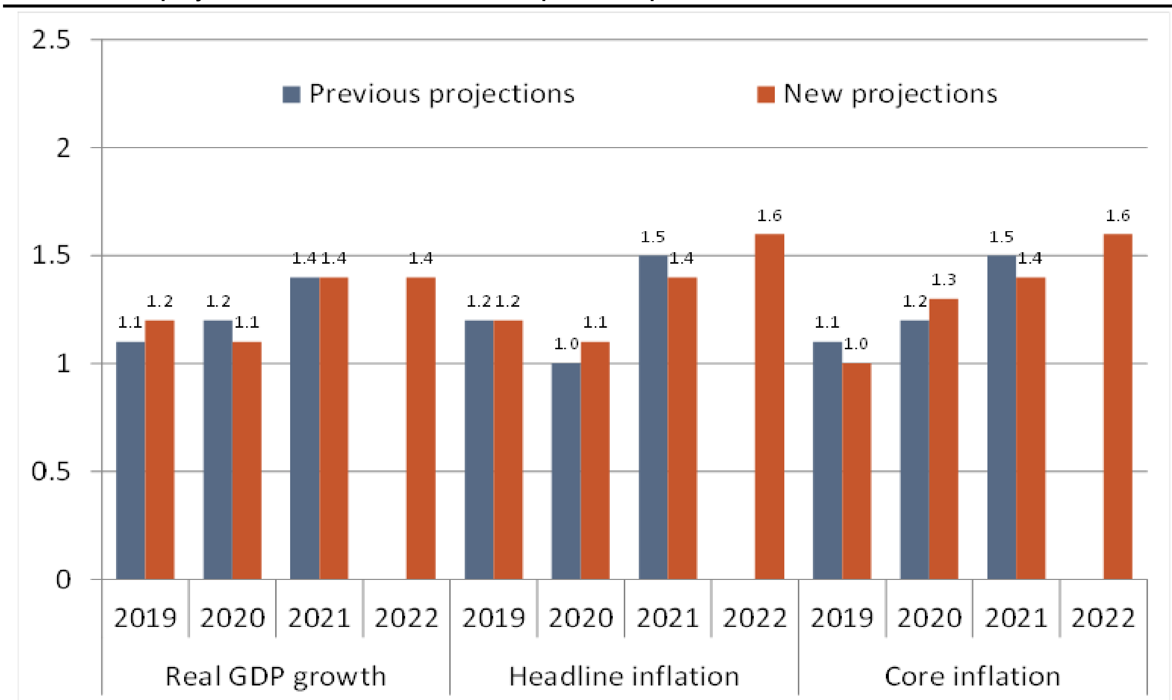
1. Tinker with the current factor of 6 times minimum reserves for the deposits which it exempts from the -0.5% penalty deposit rate. – likely
2. Drop the easing bias for interest rates and stress that rates will remain at "present levels" – rather than "present or lower levels" – less likely

**On hold again in 2021:** We expect the ECB to keep its stance largely unchanged next year, too. If in early 2021 it looks increasingly likely that headline/core inflation will rise by 1.5% – or more – on a sustained basis over the medium-term, the ECB could begin to halt its net asset purchases in late 2021, perhaps followed by a first rate hike in early 2022. If the economy remains soft and inflation is still subdued, the ECB may continue to expand its balance sheet and look for new ways to try to lift demand. Equally, if inflation surprised to the upside, the ECB could reduce some monetary accommodation from mid 2021 onwards already.

**Strategy review:** Our base case for the policy outlook in 2021 and beyond is predicated on the ECB not changing its fundamental approach to monetary policy in its strategy review. One possible surprise could come from the ECB changing its definition of price stability. Currently the inflation rate of 1.6% projected by the ECB for 2022 is not consistent with the ECB's "below, but close to 2%" target. If the ECB, in line with the Fed and the BoE, shifted to a symmetric 2% point target, we would probably push out our call of a first rate hike. Conversely, in case the ECB were to adopt a flexible target range from 1.5% to 2.5% and de-emphasise the target of 2%, the ECB could possibly tighten policy sooner.

**Some horse-trading?** A target range – instead of a point target – could be the price the doves have to pay for the hawks to raise the issuer limits on the bonds the ECB can buy from 30% to 40%. Raising the issuer limit could become a key topic of debate on the Governing Council by mid 2021 amid scarcity of German and other sovereign bonds. While the vocal backlash of the hawks to the September package suggests a lot of resistance against a potentially dovish policy move, in our view, the Governing Council's centre still gravitates around policy flexibility. It is, however, inconceivable at this point whether such an increase in the issuer limit would still be necessary in a year's time – the low point of the target range (1.5%) may be reached by early 2021.

**Chart 1: ECB projections December (new) vs. September (previous)**




*Annual growth in %. Source: ECB.*

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com