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## ECB ON HOLD DURING STRATEGY REVIEW

### Berenberg Macro Flash

**While the ECB left its policy stance unchanged at its meeting today, it revealed details about the timetable and scope of its strategy review. The review, rather than policy deliberations, will keep the ECB busy in 2020.**

#### **On hold throughout 2020 ...**

We see two reasons why the ECB will remain on hold this year: First, the economy continues to evolve in line with the ECB's baseline expectations. Some recent data show the economic downturn is bottoming. Forward-looking indicators have turned up as downside risks have become "less pronounced" – compared to "somewhat less pronounced" back in December – after the signing of a trade deal between the US and China. The ECB sees signs of a "moderate increase in underlying inflation". Second, after easing policy already in September 2019 the ECB wants to see the package unfolding.

A more general point is that, as long as the economy rebounds as expected, and with a stimulus already in the pipeline, the ECB will likely hold off any major policy adjustments until it has completed its strategy review.

#### **... and probably beyond:**

For now, we see no reason for the ECB to deviate from its current stance. If in early 2021 it looks increasingly likely that headline/core inflation will rise to 1.5% – or more – on a sustained basis, the ECB could begin to halt its net asset purchases in late 2021, perhaps followed by a first rate hike in early 2022 – in line with consensus.

#### **STRATEGY REVIEW: THE "ECB LISTENS" TOUR BEGINS**

Christine Lagarde – and a separate press release – provided more colour on the review's timetable and scope.

- **Timetable:** The ECB aims to conclude and communicate the review by end of 2020. However, Lagarde pointed out that "it will be over when it will be over", so it could possibly stretch into 2021.
- **Scope:** The review will focus on its price stability mandate – how to define, measure, communicate and implement it. While price stability will remain the ECB's primary objective, Lagarde said issues like financial stability, employment and climate change ("environmental sustainability") will also be part of the review.



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We look for the following from the strategy review:

### Inflation target

1. To stick with inflation targeting but to shift from the asymmetric and slightly confusing target of “below, but close to, 2%” to a symmetric, clearer target of “2%” – in line with the Fed and the BoE (dovish)
2. To add items to the basket of goods and services the ECB focuses on to track inflation. To the HICP, expect the ECB in conjunction with Eurostat to add costs of owner-occupied housing (hawkish) – even if this is not going to be easy
3. To place more emphasis on inflation expectations of households and businesses, in addition to professional forecasters and market-implied indicators (neutral)

### More flexibility?

1. Possibly, the ECB could introduce a **range/band** “around 2%” or “from 1.5 to 2.5%” with inflation rates within that range/band either fulfilling the target (a target range, more hawkish in the short-term, neutral impact in the future) or tolerated (tolerance band, less hawkish in the short-term, neutral impact in the future).
2. The ECB could recognise more explicitly that the appropriate **horizon** to bring inflation back to target depends on the nature of the shock – a longer horizon for mostly supply-driven shocks, a shorter period for mostly demand-driven shocks. Instead of claiming to bring inflation back to target “over the medium term”, the ECB could aim for price stability “in the long-run” (hawkish in the short-term, neutral impact in the future).

In terms of **instruments**, the ECB will probably point out that all tools ever used have proven to be effective and – if not currently being used – could be used again in the future. At the same time, the ECB will probably stress that it will not refrain from using new tools (purchasing bundles of bank loans or as last resort equities?) or change self-imposed limits.

The ECB will probably become **more transparent**. First, it will try to be more explicit in explaining the costs – and their balance with the benefits – of its monetary policy. Besides possibly holding formal votes for key decisions, it could start to publish how individual Governing Council members voted.

### Other potential issues

- **Climate change:** Almost every second question in the Q&A session was about climate change. The “environment” has clearly changed for central banks. Lagarde highlighted economic modelling, bank supervision and asset purchases as areas where the central bank should consider addressing climate change as long as it does not collide with the ECB’s mandate. For its own employees’ pension fund the ECB has already decided to increase green investments.
- The ECB could incorporate **financial stability** in its mandate to have better means to resist political pressure when setting monetary policy that puts long-term gains above short-term ones.



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