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ECB WILL BE DATA-DEPENDENT IN CONSIDERING POTENTIAL RESPONSE TO BREXIT

Berenberg Macro Flash

Despite the potential risks the Brexit vote presents to the near-term growth outlook for Eurozone economy, the ECB was decidedly neutral in their first opportunity to address market concerns since June 23. While the ECB reiterated previous guidance of being "ready, willing and able" to expand the current stimulus, if required, they did not provide a significant advance on their pre-referendum guidance. European benchmark yields mostly moved sideways following the press conference. With the ECB asking for more time, the central bankers in Frankfurt may expect no more than a near-term dent to Eurozone growth – in line with our own view.

On hold for now

The ECB's Governing Council decided to keep policy rates and the amount of monthly asset purchases unchanged. ECB President Mario Draghi reiterated that rates would remain at present or lower levels for well past the horizon of the asset purchases. Asset purchases will continue until March 2017, or until the ECB sees a sustained adjustment in the path of inflation consistent with its inflation target of just below 2%.

Risks 'tilted to the downside'

The ECB stressed that European financial markets had "weathered the spike in uncertainty and volatility with encouraging resilience" following the British vote on June 23. Financing conditions, with bank lending rates at all time lows, had contributed to credit creation picking up, supporting the on-going modest economic recovery and gradual rise in inflation. Risks are, however, tilted to the downside, as Brexit and "other geopolitical uncertainties" weigh on growth and inflation prospects.

Key takeaways from the Q&A session were as follows:

1) No need for further action, give us more time and data. Draghi noted that it was too early for the ECB to discuss adjustments to its monetary policy. He said any figures on the possible economic cost of Brexit circulating, including the 0.5% over the next three years he mentioned himself, should be taken with caution. The ECB would need more time and data, especially the staff projections in September, to "assess the underlying economic conditions" and the impact of Brexit on the Eurozone economy.

2) The ECB would act with all instruments available in its mandate, if required to do – the ECB remained "ready, willing and able". Draghi said that the nature of a policy expansion, if indeed it were necessary, would reflect the size of the negative shock and its impact on the outlook for growth and tion. Draghi also gave no mention to concerns that were ahead of today's meeting that the ECB could run out of eligible bonds to buy as more yields had turned negative following the Brexit vote. Draghi argued that the Governing Council had not discussed that issue, nor other specific instruments.

Resolving Italian banking troubles is important for transmission mechanism

Asked on the issue of Italian banks, Draghi confessed the issue was a "very complex problem", but not a problem of solvency, but rather of (lack of) profitability. Resolving the problem would be also in the interest of ECB as otherwise this could risk the proper transmission of its monetary policy, as weaker banks and lower equity prices would hamper the bank lending channel. He expressed sympathy for a "public backstop" arguing that it could be "very useful" – while stressing that European rules on resolution and recovery of banks should be honoured. He did, however, not give any details on how this should be done as this would be up to the European Commission to decide.

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