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ECB PREVIEW: MARKETS WILL HAVE TO WAIT UNTIL DECEMBER

Berenberg Macro Flash

Will Draghi announce an extension to the ECB's asset purchase programme tomorrow?
Probably not. The Governing Council will likely wait for fresh staff macroeconomic projections before they announce an extension of their monthly €80bn asset purchases beyond March 2017. The new projection including a first forecast for 2019 will be available at the December 8 meeting.

What about tapering?
Probably not. It is too early for the ECB to provide any guidance on its exit strategy. For the time being, the ECB wants markets to focus on a likely extension of its purchase programme, not on any potential scaling back of the stimulus in the future. In the Q&A session of Thursday's press conference, we expect Draghi to emphasise again that the ECB will maintain its current stance, or provide more stimulus, for as long as necessary and that ECB projections for a gradual rise in inflation are based on the assumption of a sufficient monetary stimulus. In the end, we look for the ECB to start reducing its monthly asset purchases gradually in the autumn of 2017. But for the ECB, any formal discussion about the timing of tapering now would still be premature.

Will the ECB announce any technical tweaks to its QE programme tomorrow?
Possible but not very likely. The ECB is more likely to wait until December. The ECB has asked its "relevant committees" to look at all options to prevent the ECB from running out of bonds to buy. The problem may have become a little less urgent with the recent increase in yields, including yields for scarce German bonds. More likely, the ECB will announce such technical changes (possibly raising the issue limits for AAA and AA-rated paper from 33% to 50%, buying bonds from some further issuers etc.) in December jointly with a decision to extend asset purchases by up to six months beyond March 2017. Venturing into banks bonds or equities seems rather off the radar as it would expose the ECB to too much risk and political controversy. The economic situation looks too stable to justify any big controversial new initiative. For the same reason, the ECB is unlikely to deviate from the capital key distribution of its bond purchases. While the ECB may tweak the fineprint, we do not look for the ECB to suspend the rule to not buy bonds yielding less than the ECB's deposit rule in order to not lose money on such bonds. Technical changes are highly likely. But we do not expect the ECB to announce them tomorrow already.

Other key issues for in the press conference?

- Draghi may comment on the recent bank lending survey which suggested that the negative deposit rate has a negative impact on banks' net interest income. This seems to be the case even though banks have reported a rise in lending volumes – the negative impact on loan margins more than offsets the pick-up in business.
- Draghi may also be asked what the bank lending survey results mean for future lending growth and the effectiveness of ECB policy. While credit demand is picking up gradually and the rejection rate dropped again, the Q3 survey also revealed that banks have not eased credit standards for loans to companies further in Q3 after 9 consecutive quarters of easing. Is that a sign that the negative deposit rate facility bites increasingly into banks' net interest income? The state of the banking sector and the potential interplay of political and banking risks notably in Italy could be among the issues which Draghi will be asked to address.
- Draghi will probably not want to be drawn into a discussion about Portugal, which would no longer be eligible for ECB sovereign bond purchases if DBRS rating agency were to unexpectedly cut its rating of Portuguese sovereign bonds on Friday.

In September, the markets interpreted Draghi as being slightly on the hawkish side since he did not offer any hard guidance on QE extension. Although the same may happen again, it would not be wise to take any such knee-jerk reaction too seriously. The consensus that the ECB will act in December is very strong. That should limit any adverse market reactions tomorrow. If, on the other hand, Draghi clearly sets the scene for December and chooses a dovish tone such as “the degree of monetary policy accommodation will need to be re-examined in December”, words he used in October 2015 ahead of the QE extension in December, equity markets would likely rally and while bond yields and the euro could soften.

ECB outlook

At its December meeting, the ECB will probably lower its GDP estimates for 2016 and 2017 marginally if growth in the second half of 2016 slips below the pace of 0.4% qoq as we forecast. Marginal revisions to the outlook for growth plus a projection that it will take more than two years to get close to the inflation target again will probably justify an extension of the ECB’s monetary stimulus beyond March 2017. Although the case for further stimulus is not strong in our view, we expect the ECB to announce in December that it will prolong its current €80bn asset purchases by at least 3 and more likely by 6 months beyond March 2017. In the second half of next year, we look for the ECB to start to taper its purchases - trying to avoid disruptions will be enough of a reason to go about it gently. In the absence of serious inflation pressures, the ECB can afford to move very gradually when it finally begins to scale back its stimulus.

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