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OCTOBER ECB PRESS CONFERENCE: COME BACK IN DECEMBER

Berenberg Macro Flash

At today's press conference, ECB President Mario Draghi said that the Governing Council will 'define' its medium-term monetary policy at the December meeting. Draghi responded to questions on any aspect of what the ECB could do in December with 'it wasn't discussed'. This decidedly neutral response means that the ECB, as in September, had no intention of changing or redirecting current market expectations. Markets expect the ECB to announce an extension its current QE program at the December meeting. The potential for market dislocations and volatility if the ECB didn't meet market expectations come December would be high. That the ECB didn't look to alter market expectations is significant - an extension of QE beyond March 2017 therefore is very likely.

Policy summary for October

Keeping in line with the September press conference, the ECB Governing Council left the main refinancing rate unchanged at 0.0%, the deposit rate unchanged at -0.4% and asset purchases unchanged at €80 per month. The ECB made no changes to its forward guidance, simply re-iterating its policy statement from six weeks ago:

- On rates; '*The Governing Council continues to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases'*,
- and on QE; '*the Governing Council confirms that the monthly asset purchases of €80 billion are intended to run until the end of March 2017, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim'.*

Other takeaways

- No discussion of the December agenda or tapering – but abrupt end to QE 'unlikely'
- The ECB will define its monetary policy for the coming months in December when the governing council has all inputs – this includes the committee reports on the potential scarcity of eligible paper
- No evidence that negative rates are a hindrance to transmission of QE
- Portuguese government debt would be ineligible if its rating was cut by DBRS tomorrow – *we do not expect the rating to be cut*
- All Eurozone economies need structural reform

The case for extending QE beyond March

The growth outlook for the Eurozone is positive - stable GDP growth at around trend with strong improvements in domestic demand and in the labour markets of the reformers. That GDP growth may temporarily fall a little bit below trend in the coming quarters as political risks weigh on confidence and investment does not by itself warrant a continued expansion of the ECB's balance sheet beyond March 2017. The main policy goal of the ECB is to meet the inflation target of ' just below 2%'. Headline inflation in the Eurozone is currently running at around 0.4%. Underlying inflationary pressures remain weak. Core inflation, which subtracts volatile components such as energy and food, is around 0.8%. According to ours and others' forecasts, headline inflation will probably be a little above 1% come March next year, when the current monthly asset purchases are due to end. Draghi announced today that he expects inflation to reach its goal by 2019. Although monetary policy works with a lag, ending QE in March would probably undermine eco-

nomic participants expectations that inflation will eventually return to target. From an inflation outlook viewpoint, there are good grounds to extend QE beyond March 2017.

Outlook for December meeting

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. In addition the ECB will likely project that it will take more than two years to get close to the inflation target of just below 2%. As such, we expect the ECB to announce that it will prolong its current €80bn asset purchases by at least three and more likely by six 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.