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ECB: FIRMER RECOVERY BUT NO NEED TO CHANGE POLICY

Berenberg Macro Flash

On behalf of Holger Schmieding:

Spring is coming and the ECB is celebrating. The European Central Bank today upgraded its assessment of the economic outlook, attributing the firming recovery and the fading of deflation risks partly to the success of its policies. However, as underlying inflation pressures remain subdued, the ECB has not changed its policy stance or the major parts of its guidance. Acknowledging the lessening risks of deflation, the ECB merely weakened that part of its guidance which had pointed to possible further monetary easing in the future. The ECB thus signals that, while the risk that it may have to loosen policy further has diminished, it has not moved significantly closer to actually tightening policy.

While tapering, or a gradual reduction of QE, was not discussed, we expect the ECB to gradually phase out asset purchases from January 2018 onwards and start raising its main refinancing rate in September 2019. We see today's modest tweaking of the ECB's rhetoric as a precursor to a shift from an easing bias to a neutral bias in June, possibly coupled with an easing of the ECB's penalty rate on bank deposits at the ECB from -0.4% to -0.25%. When asked – like in January – whether the ECB would rule out hiking rates before the end of the asset purchase programme, ECB president Draghi de facto dodged the question again.

The modestly more positive outlook shows up in a number of ways:

- The ECB upgraded its economic outlook for 2017 (from 1.7% to 1.8% GDP growth) and 2018 (from 1.6% to 1.7%) and its projections for headline inflation in both years. Crucially, however, the ECB did not change the outlook for 2019, that is, for the year in which any monetary policy decisions taken now could be expected to show their full impact.
- The ECB now sees a "steadily firming recovery" with a good chance that the "cyclical recovery may be gaining momentum".
- While the ECB maintained the view that the risks to its growth outlook "remain tilted to the downside", it now regards these downside risks as "less pronounced" than it did before.
- As a signal that the urgency for monetary accommodation had fallen, the ECB dropped the sentence in the introductory statement that "if warranted to achieve its objective, the Governing Council will act by using all the instruments available within its mandate".
- The ECB did not announce a new (third) round of TLTROs. TLTROs offer very favourable long-term funding conditions to banks to encourage lending to the real economy. The current, second round of TLTROs runs out this month.

Forecasts

	GDP			Inflation		
	2017	**2018**	**2019**	**2017**	**2018**	**2019**
ECB Mar 2017	1.8	1.7	1.6	1.7	1.6	1.7
ECB Dec 2016	1.7	1.6	1.6	1.3	1.5	1.7
Bloomberg consensus	1.5	1.5	1.4	1.6	1.5	1.7
Berenberg	1.6	1.6		1.5	1.6	

Yoy, in %. Source: ECB, Bloomberg, Berenberg

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