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ECB PUTS ITS MONEY WHERE ITS MOUTH IS

Berenberg Macro View

Reacting to the recent rise in bond yields, the ECB today announced that it will conduct asset purchases under its Pandemic Emergency Purchase Programme (PEPP) "over the next quarter … at significantly higher pace than during the first months of this year".

Despite some verbal interventions against the sell-off in bond markets, the ECB had not raised its net asset purchases in the last few weeks. Financial markets were thus on the tip of their toes ahead of the ECB meeting. The ECB did not disappoint them. Instead, **the clearly worded outright commitment to pump up the volume over the next three months was somewhat a dovish surprise**. We and many other financial market participants had expected the ECB to merely raise it as a possibility and conditional of a further tightening in financing conditions. The euro depreciated relative to the US dollar from 1.197 to 1.195. Long-term bond yields fell by 4-8bps after the press release.

The ECB apparently judged that financing conditions have tightened at least partly in a way "inconsistent with countering the downward impact of the pandemic on the projected path of inflation". By stressing it is about "preventing" an unwarranted tightening of financing conditions, the ECB focusses on **preserving favourable financing conditions** in the future by containing the rise in (nominal and in particular real) bond yields and/or a (further) tightening of credit conditions. The ECB does not seem to want to reverse the increase in yields in 2021.

Lagarde pointed out that the decision will be implemented as of today. **Next Monday's publication of weekly asset purchases would thus not show a huge increase yet.** Redemptions would also be high again. Lagarde stressed that the ECB would make purchases across the entire yield curve, rather than only at the long end of the curve. Yields at the long-end of the curve have increased more this year than at the short end.

The ECB would not be the ECB if it would not maintain a sufficient amount of flexibility with respect to purchases under PEPP. It left open to speculation …

- the actual pace of weekly asset purchases (after c€14bn so far in 2021, we expect an increase to €20bn or more but less than the €26bn on average during the height of the first wave in April/May 2020),
- and whether the higher pace reflects a front-loading of the PEPP, or is a precursor of another increase of the total envelope of €1850bn lateron.

With respect to the latter issue, ECB President Lagarde stressed that, whether the ECB would use up all the envelope, increase it or purchase less than the €1850bn, would continue to depend on the intermediate target of maintaining favourable financing conditions and the ultimate goal, the return of inflation towards its target. By 5 March (latest available data) the ECB had purchased assets worth €879bn under PEPP. If the ECB were to maintain the average pace of asset purchases since the start of PEPP (€18bn euros per week), it would have purchased €1850bn by late March

2022. **A weekly purchase pace of €20bn from now on would move that date forward to early February 2022**

Ironically, **Lagarde cut into the ECB's flexibility in one way by stressing that the quarterly staff projections would provide a helpful basis to decide on the pace of PEPP purchases**. We thus expect the ECB to discuss changes to the pace of PEPP and other policy decisions at the meetings when the Governing Council gets to see a fresh round of forecasts (March, June, September and December meetings).

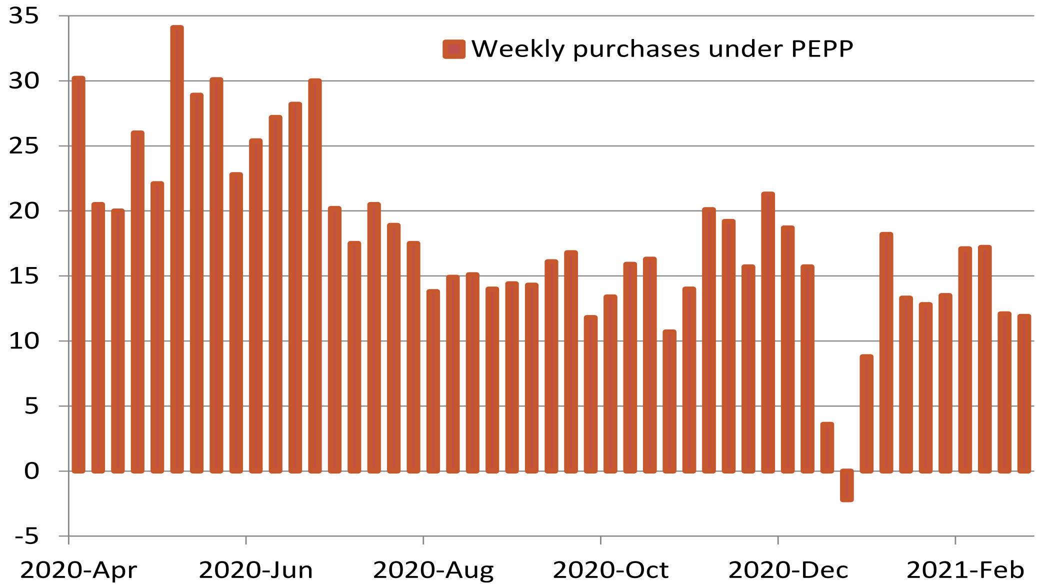
FORECASTS: NEAR-TERM MORE INFLATION – MEDIUM-TERM OUTLOOK UNCHANGED

Besides announcing a faster pace of asset purchases for the next quarter under its PEPP and reiterating that it is always ready to adjust its instruments, the ECB kept its monetary policy stance broadly unchanged.

The medium-term outlook has not changed much relative to the ECB's December staff macroeconomic projections. The ECB continues to expect the Eurozone GDP to return to pre-pandemic levels by mid-2022. It kept its 2023 calls for both real GDP growth and headline inflation unchanged at 2.1% and 1.4% respectively. It revised its near-term forecasts, in the case of inflation significantly. Powerful one-offs boost the annual change in prices by much more than previously-expected. The ECB now projects an average inflation rate of 1.5% instead of 1.0% for 20212 and of 1.2% instead of 1.1% for 2022. The ECB, however, emphasised it will look through the one-off driven inflation spike during 2021.

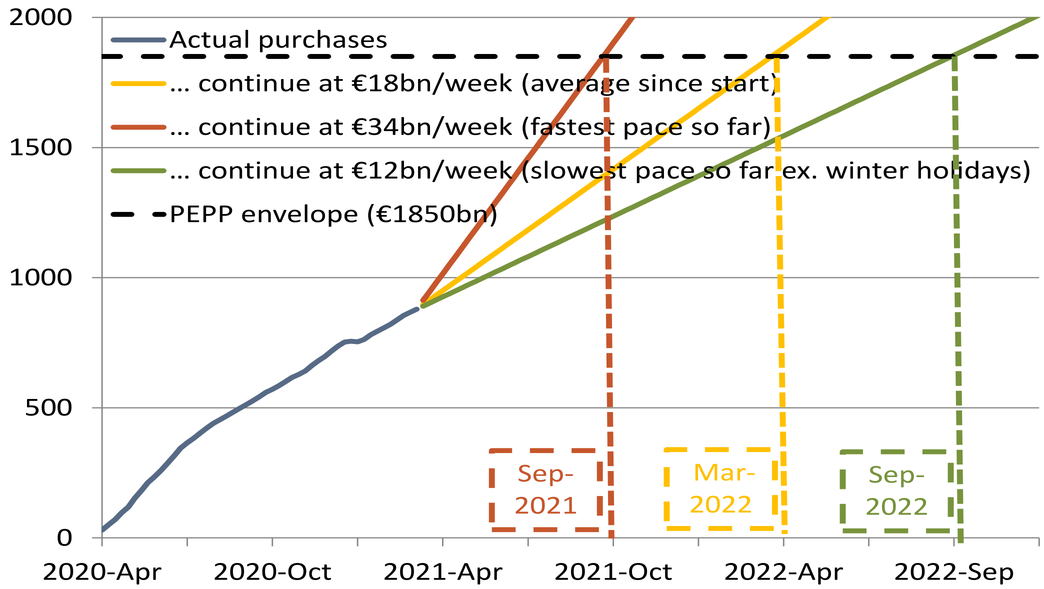
Lagarde stressed that the just agreed-upon $1.9trn fiscal stimulus in the US had not made it into the staff projections. For the positive impact to the growth and inflation forecasts to materialise, we would have to wait until the June projections. Lagarde used her reply to a US fiscal question to stress once again how important a sufficiently-sized fiscal stimulus also in the Eurozone was to fast-track the return to pre-pandemic activity levels and get EU countries on track for the future.

Chart 1: Weekly asset purchases under PEPP (in bn euros)



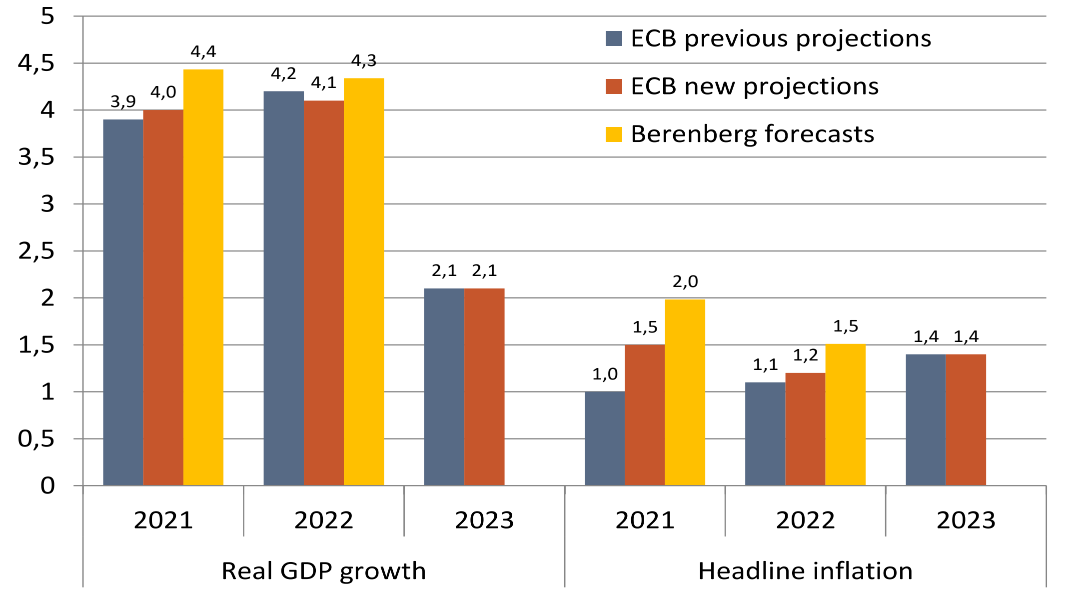
Source: ECB, Berenberg

Chart 2: Projections of when ECB will hit PEPP target



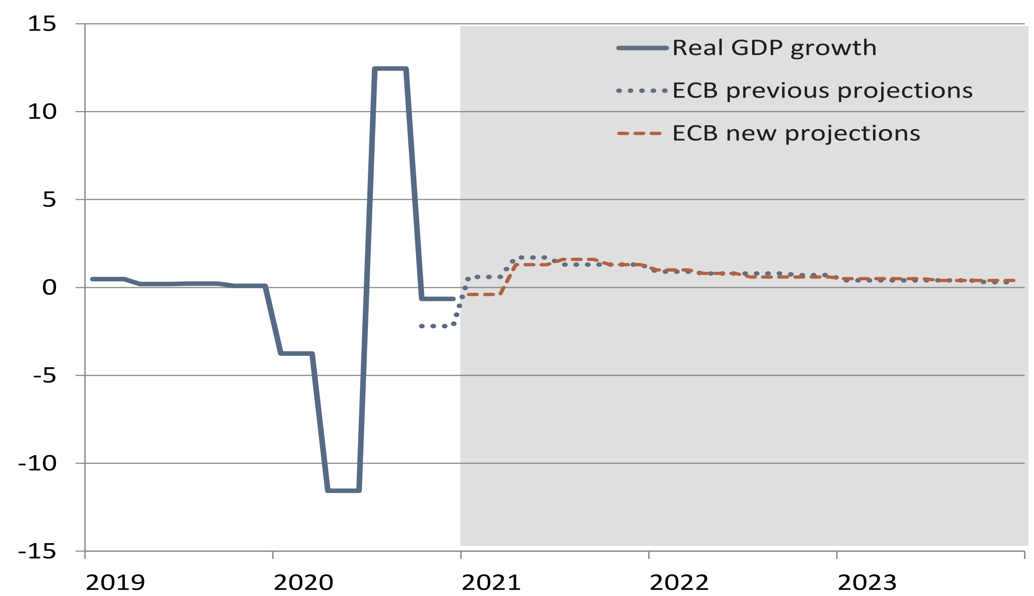
In bn euros. Sources: ECB, Berenberg.

Chart 3: ECB annual projections vs. Berenberg estimates (yoy, in %)



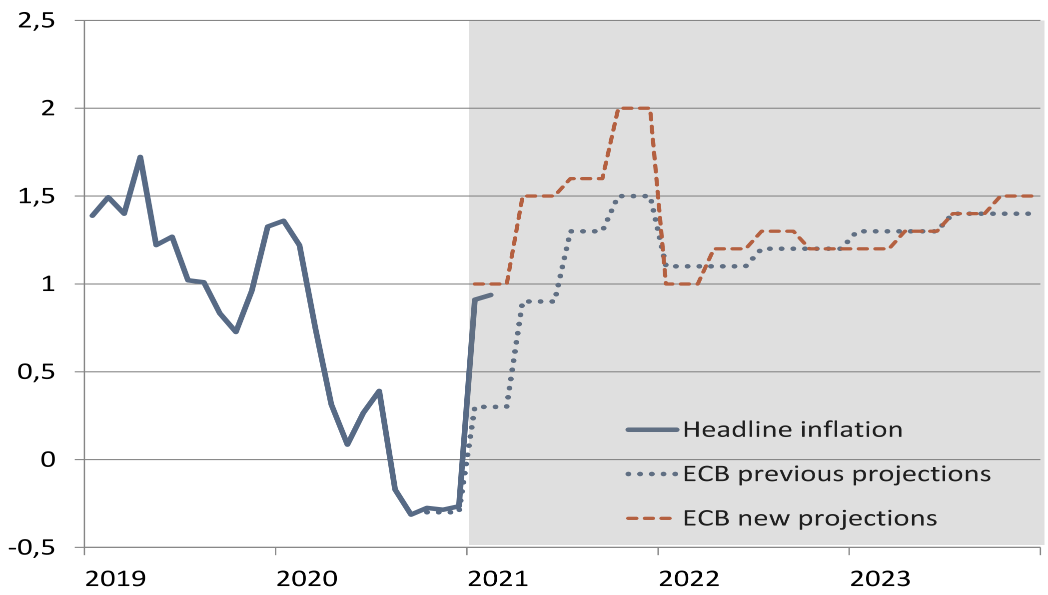
Sources: ECB, Eurostat, Berenberg.

Chart 4: Real GDP growth – ECB old vs. new quarterly projections (qoq, in %)



Sources: ECB, Eurostat, Berenberg.

Chart 5: Headline inflation – ECB old vs. new quarterly projections (yoy, in %)



Sources: ECB, Eurostat, Berenberg.