

## ECB preview: More

We expect the European Central Bank to announce that it will increase its Pandemic Emergency Purchase Programme at next week's meeting



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Working from home has given us all the opportunity to listen to our favourite music without disturbing colleagues. A treasure from the basement could be the soundtrack to next week's ECB meeting: the song ["More" from The Sisters of Mercy](#).

'Too much just ain't enough' could be ringing out of Christine Lagarde's office next week, as we expect the ECB to increase the size of its PEPP.

### ECB will present its latest macro projections

At the core of next week's meeting will be the newest set of staff forecasts. Needless to say that the March projections, which predicted GDP growth to come in at 0.8% this year, are heavily outdated. For the April meeting, ECB staff had prepared three different scenarios, with real GDP dropping by around 5%, 8% and 12% under the mild, medium and severe scenarios, respectively, in 2020.

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According to recent statements by ECB President Christine Lagarde and other ECB officials, the mild scenario has also become highly unrealistic and next week's forecasts could be somewhere between the medium and the severe scenario. For comparison, we still expect the eurozone economy to shrink by around 8% this year, the European Commission had -7.7% in its latest forecasts.

To be clear, given the unprecedented nature of the current crisis, no single model, no matter how sophisticated, is able to fully capture what is going on in the economy.

## What is it that we know?

Judging from 1Q growth, the stricter the lockdown measures, the more severe the hit to the economy. There is no hard data available yet for the second quarter.

Soft indicators suggest that April was the lowest point and that May saw some rebound in activity. Google mobility data shows that some eurozone countries have already returned to more than 80% of their January activity levels, while others are only back to some 60%. Looking beyond the second quarter, the shape of the recovery highly depends on assumptions of the epidemiology of the virus, the effectiveness of the containment measures and the lifting of these measures as well as the more permanent damage caused by the containment measures. We will have to see whether the ECB adds any new insights to the existing forecasts.

Even more interesting than the growth forecasts could be the inflation projections.

The ECB did not present any inflation projections in its scenario analysis in the 30 April meeting. In March, the ECB still expected a gradual acceleration of headline inflation from 1.1% in 2020 to 1.4% in 2021 and 1.6% in 2022.

Earlier this week, Executive Board member Isabel Schnabel said that "one number of particular interest is the evolution of the medium-term inflation outlook." With the drop in energy prices, increasing unemployment and a widening output gap, it is hard to see how this medium-term outlook cannot have deteriorated in the new forecasts. Still, judging from the minutes of the April meeting, not all Governing Council members seemed to be convinced, as some members pointed to potential upward pressure on prices from supply disruptions, weaker market competition and changes to supply chains.

We think that this will be a minority view in next week's inflation projections.

## What to expect from next week's meeting

There will be more to discuss than just the macroeconomic backdrop. The ruling of the German Constitutional court, as well as the possible exhaustion of the 750 billion 'envelope' of the PEPP programme by September or October, will demand an intense discussion on a possible increase to the programme. The ECB will also investigate possible scenarios around how to continue with

the Public Sector Purchase Programme without Bundesbank participation.

The longer we think about it, the stronger the arguments are for the ECB to decide on a significant increase to the PEPP at next week's meeting. Sure, they could wait until September, when hopefully the real shape of the recovery will be clearer. However, the fact that the PEPP will be exhausted by October, at least at its current pace, could quickly lead to unwarranted speculation in financial markets. Pre-emptively denting such speculation would argue for a June decision.

Also, PEPP is currently the easiest way to keep the Bundesbank on board, despite the German court's ruling and the deviation from the capital key could be easily tackled by increasing the overall size of the programme. Finally, the ruling of the German Constitutional court gives the ECB freedom in any tailor-made or event-related action but not so much in a more general "the economy still needs monetary stimulus" sense. Consequently, the court's ruling could actually motivate the ECB to increase the size of the PEPP while the eurozone is still in the middle of the pandemic rather than when the worst might already be over.

Strike while the iron is hot.

Given all of the above, we expect the ECB to increase the PEPP by some €500 billion at next week's meeting to extend the programme to mid-2021. Also, following the principle of the earlier collateral easing, the ECB could also decide to include so-called 'fallen angels' into the programme, announce that the proceeds from PEPP will be reinvested and could take another look at the tiering system. In the end, the ECB will have to balance doing more now (perhaps with one last big push) with continuing speculation about its ability and willingness to do more in the future.

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