

ECB preview: One final move

Extending the current level of stimulus rather than significantly increasing the stimulus seems to be the ECB's preferred option next week.



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Expectations are high for next week's ECB meeting. At the October meeting, ECB president Christine Lagarde broke with an unwritten communication principle of her predecessor, Mario Draghi, to 'never pre-commit'. Instead, Lagarde de facto preannounced new ECB action next week, calling it a 'recalibration' of all instruments.

New round of macro projections

The reasons for new ECB action are clear: with the second lockdowns the September projections have become outdated and too optimistic. Back then, the ECB had penciled in 3.1% QoQ growth in the fourth quarter. This number will have to be revised downwards significantly. At the same time, the more positive prospects on the back of recent vaccine news could lead to an upward revision of the ECB's growth projections in H2 next year. Overall, we expect downward revisions for the 2021 and 2022 growth projections (5.0% and 3.2% in September).

As regards inflation, the second lockdown has illustrated the current measurement problems, showing prices for goods and services that currently are not available. Given the latest drop in

headline inflation, the ECB's expected -0.2% YoY for the fourth quarter could turn out to be optimistic. Looking ahead, however, a reversal of the German VAT reduction as well as some price increases in the most-hit sectors should lead to a gradual increase in inflation. Overall, we don't expect significant changes to the inflation outlook, which was at 1.0% for 2021 and 1.3% for 2022. An important forecast will be the first release of a 2023 forecast. The distance between this 2023 forecast and 2% will be an important needle in the ECB's compass going forward.

The stronger euro exchange rate will be a complicating factor for the ECB. The latest appreciation only materialized after the cut-off date of the staff projections and will therefore not be reflected in the forecasts. At current levels, the stronger euro could easily shave off another 0.1 percentage point of both the GDP growth and inflation forecasts.

The case for new ECB action

The eurozone economy needs fresh support to get through the second lockdown and to start a recovery next year. However, this is not a crisis in which monetary policy is the main actor but fiscal policy. The ECB is very well aware of this situation and knows that excessive new monetary stimulus will hardly be a gamechanger for the economy. Therefore, and even if the ECB might formulate it differently, the ECB has in our view two main objectives: (i) provide enough cheap liquidity so that the eurozone recovery can unfold once the vaccine will be rolled out; and (ii) prevent a new euro crisis from unfolding on the back of widening bond yields.

With all of the above in mind and also assessing recent official speeches and interviews, we expect the ECB to decide on the following next week:

- An increase in the PEPP programme by up to 500bn euro to extend this programme until the end of 2021
- An increase of the monthly APP purchases from 20bn euro to 40bn euro, open-ended
- An extension of the generous TLTRO interest rate by six to 12 months
- An increase in the tiering facility to exempt a greater part of the banks' liquidity from the negative deposit rate
- Potentially, including so-called Fallen Angels (corporate bonds downgraded during the crisis) into the corporate bond purchasing programme.

The aim of all ECB measures will be to extend the current very accommodative monetary stance, rather than increasing it. This current crisis is a crisis in which fiscal policy, not monetary policy, can make the difference for the economy. Therefore, while still vague enough to keep the door open, Christine Lagarde will try to signal next week that this new round of monetary action will really be the last one

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