ECB preview: Sleepwalkers or simply cool dudes?

Thursday's ECB meeting will probably be low on action but high on controversial debates and challenging questions

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With only few signs of a bottoming out of the recent loss of momentum, lingering "no deal" Brexit turbulence and hardly any inflationary pressure, calls on the ECB to get back into crisis mode are growing louder. In our view, however, there is still no need for the ECB to change its course. Instead, continuing the current strategy of driving on manual, with increased alertness, looks like the best plan for this week's meeting.

Eurozone economy between slowdown and contraction

Admittedly, data releases since the December meeting have done little to stop fears of a more prolonged slowdown of the eurozone economy. Confidence indicators are still plunging, hard data remains weak and latest Brexit developments suggest that new turbulence in both financial markets and the real economy is still on the horizon. The December forecast of 1.7% GDP growth in 2019 looks increasingly unrealistic.

At the same time, however, the jury is still out on whether the current slowdown is the result of one-off, temporary, factors or rather the start of a structural slowdown. While domestic demand in the eurozone is still holding up well and low inflation and dropping unemployment bode well for consumption growth this year, increased uncertainty stemming from trade conflicts, China and Brexit could easily feed into a negative sentiment loop. Truth is, with positive outcomes, these current external risks could also quickly morph into positive growth drivers.

Highly alert cool dudes but no sleepwalkers

For the time being and despite the loss of growth momentum, the ECB seems to follow the view that the eurozone economy is in an intermediate phase of slowing but not contracting. This means that the ECB will play for time, in our view. The situation is not (yet) threatening enough for the ECB to return to crisis mode, nor is there a quick-win instrument left in the ECB's toolbox. Consequently, we expect ECB President Mario Draghi to leave the ECB's forward-guidance on rates unchanged, while at the same time, adding a dovish note by stressing the ECB's data-dependency and downside risks to growth.

In fact, given that the current external uncertainties look unlikely to be resolved any time soon, we think the ECB will wait at least until the June meeting before it changes its forward-guidance on rates. In the meantime, an option to make the current dovish bias a bit more credible could be to signal the ECB's willingness to conduct new longer-term liquidity operations, for example, by announcing on Thursday that the Governing Council has tasked the relevant committees to look into ways to tackle possible liquidity shortages and to investigate the impact from the negative deposit rate on banks.

With the recent loss of growth momentum and increased downside risks to the growth outlook, stemming from trade, China and Brexit, the risk of the ECB sleepwalking into the next crisis has increased. For the time being, however, being a cool dude who is on high alert rather than panicking into impulsive action seems to be the right strategy.

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