

ECB: December meeting recap

Please see ING's views on the 10 December ECB meeting.

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ECB: Recalibration, no stepping up of stimulus

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The ECB just announced a set of new policy measures. These announcements all fall into the category “recalibration” and not “additional easing”. Here are the main elements of what the ECB just announced:

- Pandemic Emergency Purchase Programme: The ECB’s emergency quantitative easing programme will be increased by €500 billion to a total of €1.85 trillion, to ensure that net purchases will last at least until March 2022.
- Reinvestments: The reinvestments of the principal payments from the PEPP purchases will run at least until the end of 2023.
- Asset Purchase Programme: The ECB’s ‘traditional’ QE programme to bring inflation back to target continues to run at €20bn per month, open-ended.
- Pandemic emergency longer-term refinancing operations (PELTROs): The ECB’s emergency funding scheme will be continued into 2021.
- Targeted longer-term refinancing operations (TLTROs): The ECB’s funding-for-lending scheme will be extended by 12 months until June 2022, and the amount banks can get from the ECB was increased to 55% of the eligible loan stock, from 50%.
- Collateral: The easing of collateral rules was extended in line with the extension of the

TLTROs until June 2022.

All these steps are real central bank engineering, something ECB President Christine Lagarde called 'recalibration' at the October meeting, but no actual stepping up of monetary stimulus. Instead, the ECB's main aim is to extend the current level of monetary accommodation until mid-2022. The press conference starting at 2.30pm CET will shed more light on the ECB's current thinking as well as the latest macro-economic projections. Stay tuned.

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Extend rather than increase monetary stimulus. This is the main takeaway from today's ECB meeting. As expected, the ECB left interest rates unchanged but decided on a set of recalibrations to its existing measures, all aimed at extending the current monetary stimulus by roughly nine months. Why nine months? Well, ECB President Christine Lagarde explained it clearly: with nine months, the current measures are extended until early 2022, the moment when - according to the consensus expectation of virologists and vaccine experts - herd immunity in the eurozone should have been achieved and the economic recovery can finally take off. Here are the main elements of the ECB's policy decisions and the most interesting comments from the press conference.

Today's main ECB decisions

- **Pandemic Emergency Purchase Programme:** The ECB's emergency quantitative easing programme will be increased by €500 billion to a total of €1.85 trillion, to ensure that net purchases will last at least until March 2022.
- **Reinvestments:** The reinvestments of the principal payments from the PEPP purchases will run at least until the end of 2023.
- **Asset Purchase Programme:** The ECB's 'traditional' QE programme to bring inflation back to

- target continues to run at €20bn per month, open-ended.
- Pandemic emergency longer-term refinancing operations (PELTROs): The ECB's emergency funding scheme will be continued into 2021, with four operations.
 - Targeted longer-term refinancing operations (TLTROs): The ECB's funding-for-lending scheme will be extended by 12 months until June 2022, and the amount banks can get from the ECB was increased to 55% of the eligible loan stock, from 50%.
 - Collateral: The easing of collateral rules was extended in line with the extension of the TLTROs until June 2022.

In short, the ECB tweaked all its instruments to extend the current level of monetary accommodation until spring 2022.

Main takeaways from the press conference

In the ECB's macro-economic assessment there were very few surprises. Back in September, the ECB had still been optimistic on the fourth quarter but the recent lockdowns mean it now expects a contraction. As a result, the ECB's staff projections for 2021 were revised downwards but revised upwards for 2022. The staff projections show GDP growth rates of -7.3%, 3.9%, 4.2% and 2.1% for the years 2020 to 2023. With the expected roll out of a vaccine, according to the ECB, the medium-term prospects for growth have improved, which explains why the ECB sounded somewhat less alarmist with its risk assessment, adding that the downside risks have become less pronounced.

As regards inflation, ECB staff expect headline inflation to come in at 0.2%, 1.0%, 1.1% and 1.4% in the period from 2020 to 2023. These are slight downward revisions for 2020 and 2022. However, the forecast of 1.4% for 2023, even without taking today's decisions into account, indicates that more action will be needed to bring eurozone inflation back to target.

Against the background of a recent strengthening in the euro exchange rate, the ECB and ECB President Lagarde could not avoid addressing this topic. Contrary to the unclear message on the exchange rate at the September meeting, the wording was clear today: the ECB doesn't target exchange rates but the exchange rate plays an important role for price developments. Therefore, the ECB will monitor the exchange rate "very carefully going forward". Very little more Lagarde could have said on this one.

No big bazooka but central bank engineering

All in all, today's ECB meeting was rather unexciting with a well-balanced and well-considered extension of the well-known policy instruments. No big new bazooka. The ECB continues to follow two main aims: keep financing conditions as favourable as possible and prevent any new euro crisis on the back of an unwarranted widening of government bond yields (a.k.a. keeping the transmission mechanism smooth). The ECB has linked its policies to the virus and the vaccine. All measures are now timed and tied to the assumption that the vaccine will bring herd immunity in all eurozone countries by the end of 2021. Tweaking the duration of all measures is still possible, a real stepping up of the measures is really not. For the time being, the ECB is leaving the big bazookas to governments and concentrating on real central bank engineering.

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No surprised delivered

The bar for a dovish surprise from the December ECB meeting was set rather high and the announced mix of measures was not enough to breach it. The top-up in the Pandemic Emergency Programme Programme by EUR500bn was expected, more Targeted Longer-Term Refinancing Operations was the market's base case and with the ECB not deciding to increase monthly buying under the Asset Purchase Programme (this remains at EUR20bn per month or cutting the depo rate), this was simply not enough. See our [ECB Review](#) for more details and the list of measures announced today.

As we argued in our [ECB Cribsheet](#), there was a degree of similarity between today's meeting and the ECB meeting in September 2019. In both instances, expectations were high going into the meetings and in both instances, the ECB did not manage to exceed these expectations despite the easing measures announced. Hence, the uptick in EUR/USD seen after the policy announcement is justified in our view

As for the exchange rate, there was no strong verbal intervention against the level of the euro

("very careful monitoring" of the exchange rate is not sufficient to send the currency lower). The fact that EUR/USD is modestly up says it all.

More upside to EUR/USD and European FX

In sum, the ECB did not over-deliver and the new set of measures is not strong enough to outweigh the strong bearish USD dynamics in place (and to be in place next year as the front-end US real rate remains deeply negative) and there is more upside to EUR/USD. We target 1.25 in 2021, with strong upside risks to 1.30.

This also means an upbeat outlook for European FX, be it in the G10 and EM world. SEK and NOK should be the two best-performing G10 currencies next year, benefiting from the EUR/USD overlay as well as the favourable environment for cyclical FX. CEE FX vs USD should also do well – for the similar reasons as NOK and SEK – with a strong preference for CZK (due to the domestic monetary policy considerations). Please see our [2021 FX Outlook: Back on track](#) for more details.

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European Central Bank HQ, Frankfurt

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