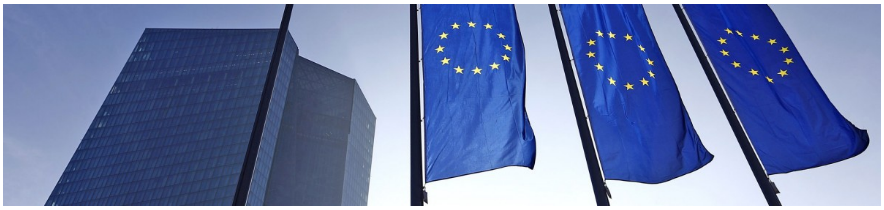
ECB: Ready to do more

The just-released minutes of the ECB's meeting on 30 April illustrates the high degree of uncertainty and the ECB's clear readiness to do more



Ready to do more and for the time being the PEPP remains the main policy tool. These are the two takeaways from the just-released minutes of the 30 April meeting.

Like it or not, the ECB, unfortunately, does not have any secret information, enabling it to see more than all other market participants. Therefore, the Governing Council discussed three different scenarios, of which the mild one was already labelled as "probably too optimistic", and different drivers of future inflation developments. Our favourite quote from the minutes: "the present situation was characterised by Knightian or "radical" uncertainty, implying unquantifiable risks."

Interestingly, the ECB cautioned that "undue risks of fragmentation could re-emerge with a further worsening of the economic outlook. It was underlined that past experience showed that a loss of confidence in financial markets had to be avoided and pre-emptive action was preferable." Together with the reoccurring theme in the minutes of the importance of PEPP, it is in our view clear that PEPP remains the ECB's preferred policy tool.

What to expect from the ECB's June meeting?

The ECB will meet again on 4 June, not as initially scheduled in Amsterdam, but once again via a video conference. With the ECB being back to its normal rhythm and hopefully without policy changes between meetings, the June meeting will be crucial. Not only will there be a new set of macro-economic projections, the ruling of the German Constitutional Court and the possible exhaustion of the 750bn envelope of the PEPP programme will ask for an intense discussion on a possible increase of the programme.

The latest Franco-German proposal on a Recovery Fund will do little to ease such a discussion, at least not as long as this proposal has made it successfully through all Brussels' committees. Until then, the ECB looks likely to have a discussion against the background of an economic recovery, in which according to ECB chief economist Philip Lane the economy will not return to pre-crisis levels until at least 2021, and disinflationary pressures due to higher unemployment, higher output gaps and low oil prices.

The longer we think about it, the stronger the arguments are for the ECB to decide on a significant increase in its PEPP programme already at the June meeting. Sure, they could wait until September, when hopefully the real shape of the recovery will have materialised. However, the fact that – at least at its current pace – the PEPP would be pretty empty by October could quickly lead to unwarranted speculations in financial markets.

Pre-emptively denting any such speculations would argue for a June decision. Also, 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 coping with the pandemic and not once the worst might already be behind.

Strike while the iron is hot.

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