The ECB is concerned

That is the main message from the just-released minutes of ECB's July meeting which stress the central bank's growing concerns about both the growth and inflation outlook. A 20bp deposit rate cut, a small tiering system, a repricing of the TLTROs and a restart of QE with some 30 billion euro per month could be Mario Draghi's last hoorah

ECB President, Mario Draghi

The ECB is concerned. This is probably the main message from the just-released minutes of the July meeting. In its discussion on both the outlook for eurozone growth and inflation, the ECB's assessment had become more pessimistic. As regards growth, the minutes say that it "was also considered that these downside risks had become more pervasive and that their persistence could ultimately also necessitate a revision to the baseline growth scenario". Looking at inflation, the recent declines in both actual inflation and longer-term inflation expectations were "a matter of concern".

The minutes suggest that there is a majority at the ECB in favour of a package of new measures, rather than a series of single measures

The official views and tone presented during the press conference in July were just a normal consequence of the discussion. The minutes do not say anything about how close the ECB is to actually act but reading between the lines, the July meeting was probably as close as it can get without actually acting. Interestingly, the minutes also suggest that there is a majority at the ECB in favour of a package of new measures, rather than a series of single measures. A "combination of instruments with significant complementarities and synergies, since experience had shown that a policy package – such as the combination of rate cuts and asset purchases – was more effective than a sequence of selective actions".

Hardly any hope that these concerns get less before September

Looking ahead, the "relevant committees" are still preparing different options for the Governing Council meeting on 12 September. While most ECB members should have returned from summer vacation by now, the macro economic picture has not improved. To the contrary, the slowdown of the eurozone economy in the second quarter, tentative signs that external problems have reached the domestic part of the economy as well as somewhat lower oil prices and a stronger euro should weaken the inflation outlook further. Still, as illustrated by today's PMIs, the eurozone is rather in a period of stagnation than at the risk of a severe recession.

> *There are increasing doubts that additional monetary easing will be a game-changer for the economic outlook*

Against all of this, the ECB has a difficult task, preparing for its 12 September meeting. At the July meeting, Mario Draghi's comments at the press conference and recent comments by the Finnish central bank governor Olli Rehn have increased expectations. At the same time, however, there are increasing doubts that additional monetary easing will be a game-changer for the economic outlook.

Interest rates across the entire board are close to record lows, financing conditions have never been more favourable and there are adverse effects stemming from unconventional measures. Still, to paraphrase Jean-Claude Trichet, the ECB's has only one needle in its compass and that needle is price stability. With no signs of inflation picking up any time soon, doing nothing is not an option. However, when looking at the different options for September action, it is not always easy to find – what Peter Praet once called - a monetary policy case.

What will happen at the September meeting?

Here is what we think the "relevant" committees at the ECB's Governing Council will discuss as possible new measures in September.

- A deposit rate cut would probably weaken the euro exchange rate but is unlikely to have a positive marginal effect on bank lending. Together with the de facto zero bound on bank interest rates, there is an adverse effect on bank profitability. Even though a tiering system could bring some relief, due to the uneven distribution of reserves and excess liquidity across Eurozone countries the implementation of any such system will be highly complicated.

- Instead, a repricing of the TLTROs would be a stronger monetary policy case. Linking the new round of TLTROs to the deposit rate, instead of the MRO, would incentivise lending growth.
- Whether lower yields on the back of restarting QE would be the game-changer for the real economy is also questionable. However, the focus on corporate bonds could support corporate investment. There should also be spill-over effects.
- Buying equity has been the Bank of Japan's last policy resort. Currently, clearly, one bridge too far for the ECB but eventually also in the eurozone the last resort.
- The rather limited marginal effects from new easing measures could in our view also bring back the concept of helicopter money. It could be a possibility to circumvent the bank-investment channels of monetary policy transmission but would support consumer spending

All of the above means that the ECB finds itself in a rather uncomfortable position. It is to demonstrate its willingness and determination to act, while at the same time it also knows that monetary policy alone can longer solve the low-growth-low-inflation problem of the eurozone. However, doing nothing isn't really an option.

Therefore, we continue to see the ECB starting a final monetary firework at the September meeting: a 20bp rate cut of the deposit rate, a small tiering system, a repricing of the TLTROs and a restart of QE with some 30 billion euro per month could be Mario Draghi's last hoorah before handing over to Christine Lagarde.

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