ECB: Dovish gamble

With new TLTROs and a change to the forward guidance, the European Central Bank (ECB) today tried to get ahead of the curve. The measures demonstrate the ECB's determination but will do little to tackle the drivers of the current slowdown

Source: Andrej Klizan

In its macro-economic assessment, the ECB has finally arrived in the Eurozone's new reality of elevated uncertainty and downward revisions to growth expectations. This is not really surprising, given that the ECB's growth forecasts from last December have always looked very optimistic. In today's meeting, the ECB made clear that it still sticks to a rather optimistic base case scenario of a gradual recovery mainly on the back of solid domestic demand. At the same time, however, the slowdown, mainly stemming from temporary and country-specific factors, "is turning out to be somewhat longer-lasting".

New ECB projections

According to the latest ECB staff projections, GDP growth is now expected to come in at 1.1%, 1.6% and 1.5% in 2019, 2020 and 2021; in the December projections these were 1.7% in 2019 and 2020 and 1.5% in 2021. The Bloomberg consensus forecast from private sector contributors is currently at 1.4% for 2019 and 1.5% for 2020. The OECD just yesterday revised its growth forecasts down to

1.0% and 1.2% respectively and the European Commission expects 1.3% GDP growth in 2019. Interestingly, despite the downward revisions of the growth forecasts, the ECB still considers risks surrounding the growth outlook to be tilted to the downside.

Inflation is currently not the most pressing issue for the ECB. It rather seems to be a derivative of economic developments. The bottom line remains a very gradual increase in headline inflation but a clear missing of the ECB's target. As regards inflation, staff projections now foresee headline inflation to come in at 1.2%, 1.5% and 1.6% for 2019, 2020 and 2021 from 1.6%, 1.7% and 1.8%, respectively, in the December projections.

Today's decisions

Against the background of significant downward revisions to the 2019 growth forecasts and increased uncertainties, the ECB today presented a new dovish surprise, announcing four measures (some new, some a confirmation of existing measures), all of which were taken unanimously:

- A change in forward guidance on rates to "interest rates to remain at their present levels at least through the end of 2019", from "through the summer of 2019". During the press conference, ECB President Draghi mentioned that some ECB members even wanted to extend forward guidance to March 2020.
- Reinvestments of the QE purchases were confirmed to continue "for an extended period of time" once interest rates have been increased.
- Seven new TLTRO with a quarterly frequency from September 2019 until March 2021, at the refi rate and no longer at the deposit rate. All with a maturity of two years. There will be "built-in incentives for credit conditions to remain favourable", similar to the last TLTROs but details were not presented.
- The "normal" ECB lending operations will be conducted as fixed rate tender procedures with full allotment at least until March 2021.

Our take on today's ECB meeting

The measures as such are not such a big surprise but the timing of the announcement is. In our view, it is an attempt to stay ahead of the curve and to avoid unwarranted tightening of the ECB's monetary stance. It is not an attempt to provide additional easing but rather an attempt to keep the balance sheet stable for a longer-than-expected period. Any rate hikes for this year are definitely off the table. At the same time, however, today's announcements have some flavour of panic as the ECB's base case scenario still foresees a gradual recovery and the 2020 and 2021 forecasts were hardly revised downwards. Today's announcements are also a bit of a gamble as they will do very little to tackle the biggest risks for the Eurozone economy, which according to the ECB stem from external sources.

In sum, the ECB's current strategy clearly follows the idea of "if you can't beat it, try to avoid it for as long as possible", hoping that today's measure are sufficient to put a floor under the current economic slowdown. Any next step from here to tackle a severe downswing of the economy would now require unprecedented measures. In any way, today's ECB meeting clearly means that Mario Draghi will be the first ECB president who never hiked interest rates during his term in office.

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