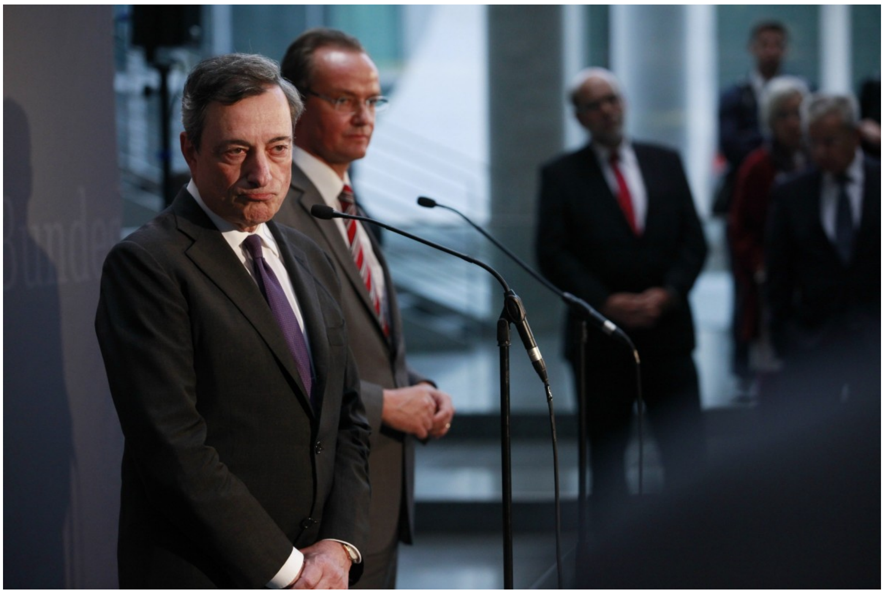
ECB: Dovish vehemence from Vilnius

Dovishness all over. With today's meeting, the European Central Bank is, in our view, only a small economic slip away from a rate cut



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At its meeting in Vilnius, the ECB today clearly tried to convey a dovish message to financial markets, demonstrating its willingness and readiness to act. Today's meeting was as dovish as it can get without actually engaging in new action.

The ECB's concerns mainly seem to be driven by increased and prolonged uncertainty, rather than the fear of an imminent collapse of the eurozone economy. In fact, the ECB's macro-economic assessment remained relatively unchanged. The latest round of ECB staff projections (to be accurate, from the eurosystem staff) showed only minor changes compared with the March projections.

- The growth outlook for 2019 was even revised upwards to 1.2% (from 1.1%), while the 2020 and 2021 forecasts were slightly lower than in March, now at 1.4% (from 1.6%) and 1.4% (from 1.5%).
- As regards inflation, there were also hardly any changes, with headline inflation now expected to come in at 1.3% in 2019 (from 1.2%), 1.4% in 2020 (from 1.5%) and 1.6% in 2021 (unchanged).

In sum, the staff projections did not actually provide sufficient room to act. Instead, ECB President

Mario Draghi explicitly cited prolonged uncertainty, noting in the press conference that the trade conflict and Brexit have not disappeared as quickly as the ECB had hoped in March. In fact, these uncertainties are here to stay for much longer, according to the ECB.

Against this backdrop of increased and prolonged uncertainty, the ECB today decided to:

1. Push its forward guidance on interest rates to "at least through the first half of 2020", from "at least until the end of 2019".
2. Offer a new series of cheap loans for banks (TLTRO III) at 10 basis points above the main refinancing rate (currently 0.1%) and 10 basis points above the deposit rate for banks reaching an ECB benchmark for net lending similar to the one in the previous TLTROs (this rate would currently be -0.3%).
3. Finally, the ECB definitely shelved the issue of a tiering system for the deposit facility for the time being, stating that the "positive contribution of negative interest rates…is not undermined by possible side effects on bank-based intermediation". Still, this discussion is not entirely dead. The ECB will continue to monitor it carefully and Draghi kept the door open, pointing to the possible necessity of a tiering system in case of changed (rate) circumstances.

Enshrining the legacy

An interesting aspect of today's change in forward guidance is that it will actually bind Draghi's successor to continue with his legacy for almost a year, at least. This was definitely not the main goal of today's decision but the Governing Council committed any next president to its current monetary policy. There will be no reversal of monetary policy like in 2011 when Draghi started his term.

Fierce determination to act

The most important part of today's meeting came during the Q&A session when Draghi repeated several times the ECB's readiness to act "if adverse contingencies were to materialise". The surprise moment was when he reported that the ECB today actually discussed options like rate cuts and restarting quantitative easing in such a scenario. According to Draghi, no one should have doubts about the ECB's policy stance.

Only one economic slip away from a rate cut

All of this means that the ECB has joined the choir of global central banks which have either already delivered new easing measures or are contemplating them. In fact, the ECB is now only a fraction away from new stimulus. It's not their preferred option but it will probably only take a small economic slip for the ECB to cut rates.

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