ECB: Draghi's final "as long as it takes"

The ECB has put all instruments on the table in what could have been the final solo attempt to restore growth and inflation in the Eurozone

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Mario Draghi leaves with a big bang. Even though today was officially Draghi's second to last ECB meeting, he today tied monetary policy to his ties for probably years to come. With what probably was his final "whatever it takes" moment, Draghi should be able to celebrate a rather calm farewell party at his very last ECB meeting at the end of October. Draghi's successor, Christine Lagarde, however, will have lots of time to focus on other issues than monetary policy. Today's decisions have anchored and enshrined the Draghi legacy in future ECB decisions. "Whatever it takes" has just been extended by "as long as it takes".

Worsening economic outlook

As expected, the ECB has become more alarmed about the outlook for the economy and inflation. As Draghi said during the press conference, the base case scenario was still a benign scenario as it didn't include the risk of a no-deal Brexit and trade wars. Nevertheless, the ECB staff projections presented downward revisions to both growth and inflation. ECB staff now expect GDP growth to come in at 1.1% in 2019, 1.2% in 2020 and 1.4% in 2021. In June, this was still 1.2%, 1.4% and 1.4%. As regards inflation, the projections now foresee headline inflation at 1.2% in 2019, 1.0% in 2020 and 1.5% in 2021. In June, this was still 1.3%, 1.4% and 1.6%.

What the ECB decided

As a consequence of the above and what Draghi called a "re-anchoring" of inflation expectations at very low levels, the ECB decided on the following measures:

- Deposit rate cut by 10 basis points to -0.5%.
- A tiering system will be introduced, where the exempt tier will be remunerated at 0% and applies to the minimum reserve times six. Both the multiplier and the interest rate can be changed over time.
- Forward guidance on rates is no longer calendar-based but open-ended and state-dependent.
- Quantitative Easing will be restarted with EUR20bn per month, starting 1 November. For the first time, there is no end date added to QE. No changes to the composition of QE purchases were announced.
- The targeted longer-term refinancing operations will be repriced and include an incentive for banks to increase lending. Along the lines of the first two generations of TLTROs, banks which exceed the benchmark ECB loans will be charged at the average deposit rate. The maturity of the TLTROs will be extended from two to three years.

Draghi - the inflation warrior

According to Draghi's comments at the press conference, the decision was not taken unanimously but on a majority. Interestingly, Draghi increased the pressure on governments to act with fiscal stimulus. For the first time in years, the language on fiscal policy in the introductory statement was changed, calling more outspokenly on governments "with fiscal space" to "act in an effective and timely manner". This follows earlier comments by other ECB officials and also Christine Lagarde that the ECB was "not the only game in town". A strong signal that the ECB is well aware of the fact that it no longer can restore growth and inflation but needs fiscal stimulus.

All in all, Mario Draghi once again demonstrated his willingness to do "whatever it takes" and also to push through against opposition. The fact that the ECB put really all possible instruments on the table sends a strong signal. The open-ended character of QE and conditionality of forward guidance simply means low rates for as long as it takes.

Mario Draghi came into office with a big bang, when he reversed the premature rate hikes under his predecessor Jean-Claude Trichet, and he will now leave with a big bang. To some extent, Draghi has become an almost ruthless inflation warrior. Like it or not but the objective of the ECB is laid down in the European Treaty and makes maintaining price stability the primary objective. "Without prejudice to the objective of price stability", the ECB should also "support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union". These include inter alia "full employment" and "balanced economic growth". Against this background and the current economic outlook, it is hard to see the ECB simply leaning back and doing nothing.

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