ECB: wait-and-see

There were few surprises in the minutes of the European Central Bank's April Governing Council meeting. The central bank pretty much remains in wait-and-see mode. The new series of targeted longer term refinancing operations (TLTROs) could become a way to fine-tune monetary policy, while a tiered deposit rate scheme is still a long shot

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Here are the key points from the minutes of the ECB's April meeting:

1 Growth disappoints, but the Governing Council remains hopeful

The members of the Council acknowledged that there is a more protracted soft patch, but they believe a more solid growth rate in the second half of the year is still to be expected. That said, the risks surrounding the growth outlook remained tilted to the downside.

2

Inflation is too low, but underlying inflation is still expected to increase

Underlying inflation remains muted and inflation expectations have declined. However, the Governing Council still thinks that stronger wage growth should lead to higher inflation and that there is still no sign of inflation expectations becoming unanchored.

3 Only limited concern about the impact of low bank profitability on the pricing of credit risk

Cost efficiency, excess capacity and the need for consolidation were seen as the reasons for low bank profitability. While further analysis was deemed warranted about the impact of persistently low and negative interest rates on the banking sector, policymakers still believe that the negative deposit rate has contributed to increased lending volumes.

4 Tiering not yet considered, but ECB will regularly assess the side-effects of negative interest rates

Members agreed that the Governing Council should also consider in its regular assessment whether the preservation of the favourable implications of negative interest rates for the economy called for the mitigation of their possible side effects, if any, on bank intermediation. So in essence, the tiering of the deposit rate could be considered if and when the bank believes that the side-effects of negative rates have become too big.

5 TLTROs could be used to adjust the monetary policy stance

The pricing of the new TLTRO-III operations should be data-dependent and take into account a thorough assessment of the bank-based transmission channel of monetary policy, as well as further developments in the economic outlook. Some arguments were put forward in favour of pricing the new operations so that they would primarily serve as a backstop, providing insurance in times of elevated uncertainty. Other arguments supported the view that the TLTRO-III operations should also be seen as a potential tool for adjusting the monetary policy stance.

All in all, the ECB stands by its assessment of a gradually improving economy with slowly rising inflation. That said, some doubt seems to be creeping in. The risks to the growth outlook are skewed to the downside, while the transmission of higher wages into higher inflation has yet to be seen. Today's flash PMI for May already casts some doubt on the rising inflation story as average prices for goods and services showed the smallest increase since July 2017, with intense competition limiting pricing power. In these circumstances, we believe that the pricing of the first TLTRO could be quite generous. As for the tiering of the deposit rate, it remains a long shot, but something that would certainly be considered if the Governing Council were to contemplate a further rate cut.

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