ECB: Policy Unchanged as Draghi Passes the Baton

- **As expected, the ECB's Governing Council made no further changes on top of the significant moves it announced on September 12 to cut interest rates, restart asset purchases, make the TLTRO's terms more generous, and introduce tiering for bank deposits. We do not foresee further rate cuts over our forecast horizon.**
- **In the press conference following the decision, Pres. Draghi reiterated his previous calls for coordinated fiscal stimulus by Eurozone states that have fiscal space and pushed back against concerns about the extent of dissension expressed by some Governing Council members following the September decision.**

WHATEVER IT TOOK

As expected, this monetary policy meeting was largely a placeholder, falling as it does between the comprehensive package of policy changes announced at the September meeting and the arrival of Christine Lagarde to the European Central Bank's (ECB) Presidency on November 1.

In a short statement, the Governing Council (GC) confirmed the need to keep monetary policy accommodative for an extended period of time. The GC kept unchanged at record lows its central refinancing and deposit rates at 0.0% and -0.5%, respectively, as was nearly unanimously expected. The marginal lending facility's rate was also kept unchanged at 0.25%, as expected.

The decision reiterated unchanged the key policy language from the September statement, which moved the ECB from date-based forward guidance to a state- and data-contingent policy stance: "The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics."

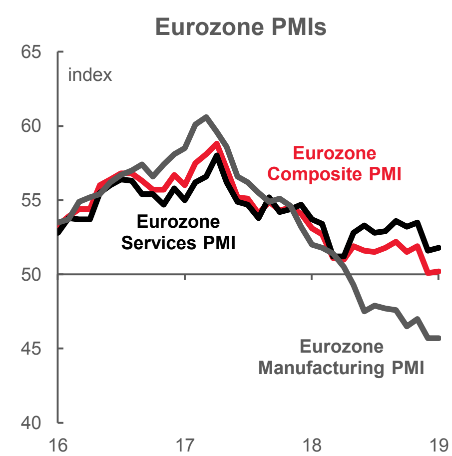
The statement also confirmed the ECB's September decision to restart quantitative easing (QE) under its asset purchase programme (APP) at a rate of EUR 20 bn per month from November with no pre-determined expiry date, effectively shifting from "whatever it takes" to "as long as it takes": "The Governing Council expects them (i.e., asset purchases) to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates." The GC also recommitted to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the ECB's key interest rates.

We do not foresee additional rate cuts over our forecast horizon, notwithstanding current market pricing for another cut, as we expect a mild improvement in macro conditions going forward as sentiment indicators bottom out (chart 1). That said, we fully expect that incoming Pres. Lagarde will take up the mantle of "whatever it takes" and would not fail to validate strong market pressures for further action if macroeconomic conditions fail to improve.

CONTACTS

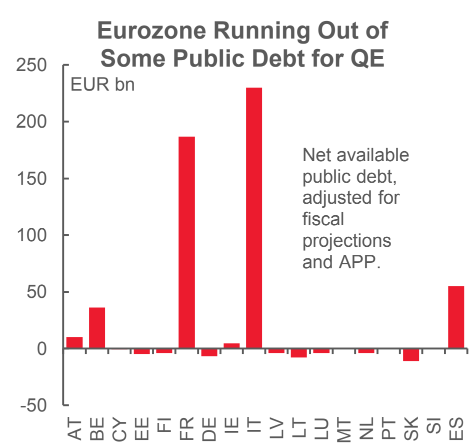
Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com
@BrettEHouse

Chart 1



Sources: Scotiabank Economics, Markit, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

PRESS CONFERENCE VALEDICTION

In the press conference following the decision, Pres. Draghi avoided communicating new messages or binding the hands of incoming President-designate Lagarde. He argued that developments—both in actual data and sentiment indicators (chart 1, again)—since September had legitimated the GC's view that ample monetary accommodation is necessary to ensure the Eurozone's convergence to the ECB's inflation target just below 2%. He contended that recent data confirm protracted weakness in growth dynamics, prominent downside risks, and soft inflation dynamics. Data also point to moderate but positive growth in H2, but Pres. Draghi noted that uncertainty remains high.

As expected, Pres. Draghi also noted again that other policy measures are need: he called for the implementation of structural measures to be stepped up to raise productivity, reduce structural unemployment, and increase resilience. The current mildly expansionary Eurozone fiscal stance is providing some support, but in view of the outlook and risks, countries with fiscal space need to act in a prudent and timely manner to provide more stimulus, he said.

In response to questions, Pres. Draghi argued that negative rates have done more good than harm: he contended that they have clearly stimulated the economy and boosted employment. He noted, however, that the ECB is mindful of possible side effects and that the move to tiering for banks reflects this concern.

Pres. Draghi did not indicate whether a revision to public-issuer limits under the APP were discussed, but he did dismiss concerns raised by several market analysts that the ECB would soon run out of space to purchase the public debt of several Eurozone members (chart 2). He recalled Chief Economist Phillip Lane's observations in September that it would take quite a bit of time before the public-issuer limits become a problem on the basis of reasonable fiscal and issuance assumptions. It also remains possible that the mix of purchases could shift to include a broader set of assets, including securities from private issuers.

When asked about the exceptional public discord amongst GC members that followed September's decision, Pres. Draghi recalled that a "clear majority" had supported the road policy package and that varying majorities supported its specific elements. He did not see the post-meeting dissents as having any impact on the effectiveness of measures agreed, and argued that markets had responded to the September decision as expected with short-term rates coming down.

Looking backward to his arrival in the midst of the Greek debt crisis, Pres. Draghi took note of Greece's recent issuance at negative rates and observed that it was now a "good time for Greece". Looking forward, he called again for the introduction of a "central fiscal capacity" in the monetary union.

Pres. Draghi noted that Christine Lagarde did not take part in discussions, but was present.