ECB: Optimism of Stale January Minutes a Poor Guide to Future Moves

- **The *Minutes* from the January 23 monetary policy meeting reiterated the emerging optimism that featured in Pres. Lagarde's press conference that day, but the basis of that hope has since softened and new downside risks have emerged. The *Minutes* provide little insight into current ECB thinking.**
- **Our view remains unaltered that the ECB will keep its policy rates and asset purchase programme (APP) unchanged through end-2021.**

A BRIEF MOMENT OF HOPE

The *Minutes* from the January 23 monetary policy meeting of the European Central Bank's (ECB) Governing Council (GC) reflected the slightly glass-half-full tone of President Lagarde's press conference, but most of the reasons for her incipient optimism have since waned. In her comments on January 23, Pres. Lagarde noted that there may be signs of a moderate firming in underlying inflation dynamics, but January headline inflation remains at 1.4% y/y and core at 1.1% (chart 1), so any apparent stiffening in price dynamics has not yet had an impact on key indicators—and is unlikely to do so for some time based on recent developments, consistent with major forecasts (chart 2). For instance, Q4-2019 real Eurozone GDP growth undershot expectations and came down from 0.3% q/q in Q3 to 0.1%, while PMIs remain soft (chart 3). As a result, the *Minutes* are a stale reflection of ECB thinking, don't provide much guidance toward future moves, and merit only a brief review.

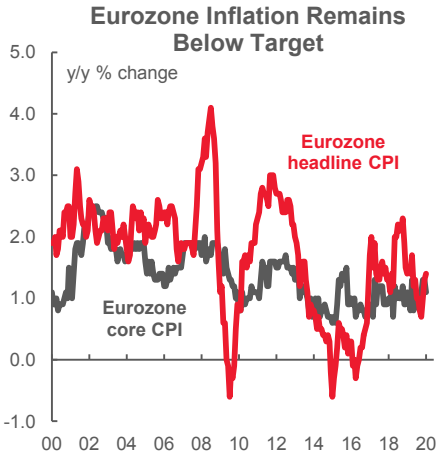
Overall, the *Minutes* confirmed Pres. Lagarde's verbal assessment that recent data are broadly consistent with the ECB's prior expectation of ongoing, moderate growth, while also pointing to nascent signs of strength in more forward-looking data and developments. Those signs of strength now look more delicate and fleeting than the GC's assessment in the *Minutes*. The GC noted that risks are still tilted to the downside, but that recent developments in trade policy—the signature of the US-China phase 1 trade deal, greater clarity on the UK's moves to enact Brexit by end-January, US efforts to ratify the USMCA, and some temporary moderation in White-House threats toward Europe—made some of these risks slightly less pointed. Since then, UK PM Johnson's insistence on completing a UK-EU trade deal by end-2020 and gaps between the Westminster and Brussels negotiating positions imply that newly-found clarity on Brexit was fleeting. Similarly, fresh efforts by the US to impose tariffs on EU imports imply that tensions with Washington could escalate in the coming months and will provide an ongoing dampener on business activity.

The January 23 meeting date was too early to assess adequately the impact of the novel coronavirus outbreak, which adds downside risks to the *Minutes'* assessment. At the time of the meeting, expectations for the scale and scope of the outbreak were much more modest, and the projected impact on Chinese demand and supply chains was more limited in the GC's view than recent developments would imply. While ECB Chief Economist Philip Lane underscored

CONTACTS

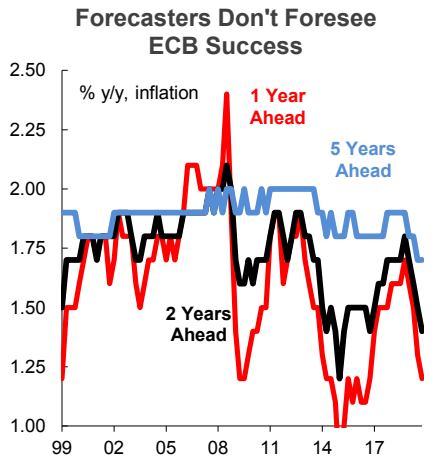
Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Bloomberg, Eurostat.

Chart 2



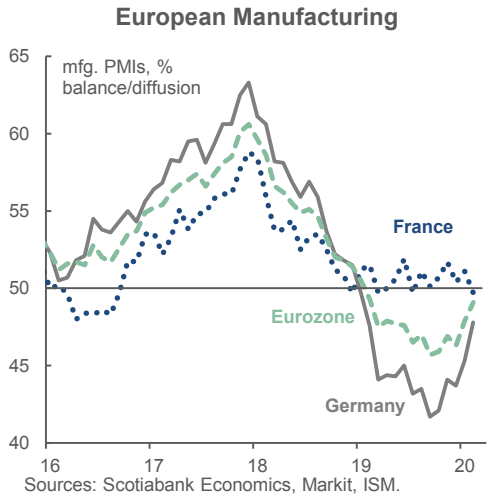
Source: ECB Survey of Professional Forecasters, Scotiabank Economics.

in a speech today that the Bank expects the outbreak to impose a "V-shaped" effect on the European economy (i.e., a sharp shock with a quick rebound), the depth of this V is undoubtedly going to be greater than the GC might have expected on January 23.

HOPE DASHED, THE ECB IS SET TO STAY ON HOLD THROUGH 2021

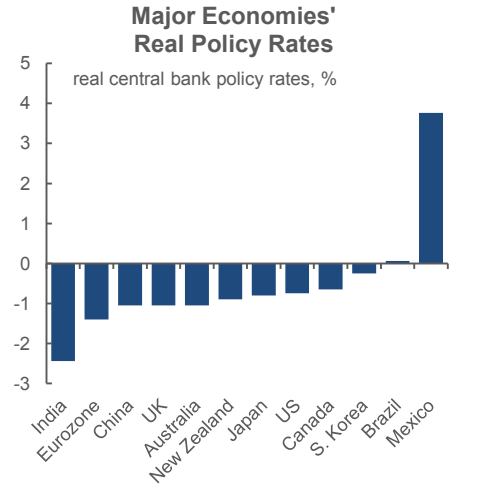
Although current conditions and future prospects are both now weaker than they appeared a month ago, the *Minutes* don't point to any reason to think the ECB will ease policy any time soon—and will instead remain on hold over our forecast horizon at what is already a very accommodative stance (chart 4). We didn't think Pres. Lagarde's upbeat tone on January 23 was justified—and so its failure to find corroboration doesn't change our outlook. The large package of monetary stimulus measures agreed in the autumn of 2019 have only begun to be implemented and have an effect on the Eurozone economy. As we've previously noted, the bar for any further easing with the Governing Council's hawks remains very high. As a result, we continue to expect the ECB to keep its policy rates and asset purchase programme (APP) unchanged through end-2021. If economic conditions continue to deteriorate, calls for the use of fiscal space—and means to expand it—will grow louder, accompanied by measures to expand the set of securities eligible for the APP.

Chart 3



Sources: Scotiabank Economics, Markit, ISM.

Chart 4



Sources: Scotiabank Economics, Bloomberg.