

Active is: Anticipating what's ahead

The ECB's monetary-easing policy is here to stay

2019/04/08   

Summary

Recent ECB comments suggest that the horizon for a rate hike may be moving further away, based on the central bank's uncertain growth outlook and concerns over weak inflation. The ECB is also keen to preserve banks' ability to lend to the euro-zone economy.

Key takeaways

- We expect the ECB to confirm its extremely accommodative monetary policy stance at its next meeting; the pause in normalisation could last, and short-term rates are well anchored
- The ECB is likely to emphasise its uncertain outlook for growth and concerns about weak inflation expectations as justification for its ultra-accommodative policy
- Look for the ECB to highlight that it still has room for further monetary easing, although this could fuel market uncertainty

When the ECB's monetary policy committee next meets, on 10 April, we expect it to confirm its extremely dovish stance. Mario Draghi implied as much after the ECB's March meeting, when he announced the bank's intention to leave the deposit rate unchanged, at -0.40%, until at least 2020. Mr Draghi went even further during a 27 March conference, where he stated that he was reflecting on ways to preserve the benefit of negative rates for the euro-zone economy while mitigating their side effects on banks.

This suggests that the horizon for a rate hike is moving further away – or even that the -0.40% deposit rate could fall further in the event of a crisis. The profitability of euro-zone banks is being eroded by what is effectively a 40-basis-point tax on their excess reserves, and the ECB is keen to preserve banks' ability to lend to the economy. This raises the possibility that the ECB might announce the implementation of a multi-tier deposit facility, similar to the one set up by central banks in Switzerland, Japan, Denmark and Sweden. Under this scheme, the taxation of banks' excess reserves would be triggered above a threshold that is specific to each institution.

These new concerns could also be reflected in the terms for the third round of targeted long-term refinancing operations (TLTRO 3) – cheap loans from the ECB to banks – that are planned for September. Details are not yet available, but we would not be surprised if the ECB's new TLTRO 3 facility allows participants to borrow at a rate lower than the refinancing rate (ie, a negative rate similar to TLTRO 2).

The ECB used its recent statements to demonstrate that it still has room to manoeuvre – beyond the quantitative easing that is already part of its toolbox – and that its monetary policy has not reached its limits. At the same time, Europe's central bank is operating within a framework constrained by the US Federal Reserve's new "behind the curve" positioning, which investors perceive as a lasting pause in rate hikes.

Yet we wonder about the timing and content of the ECB's new forward guidance. The ECB insists on freeing up room to manoeuvre, but that raises questions about whether it has a worse-than-expected outlook for euro-zone growth and inflation. By highlighting economic risks and emergency measures that do not seem necessary today, the ECB could be adding fuel to the uncertainty that still weighs on the markets.

Never in recent times have short-term rates in the euro zone been so well anchored, which paves the way for lower rates throughout the curve – and for longer than investors expected. We think it is likely that the German yield curve will settle into negative territory for a prolonged time. In the event of a future euro-zone recession – which is not our base-case scenario – the prospect of an even more negative deposit rate could lift long-term rates into unknown territory. In this context, one thing is certain: more than ever, the motto "never short the Bund" seems valid.

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2019/04/08



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2019/05/27



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Summary

While the pro-European vote held up in many countries, the result will likely be a more fragmented European Parliament that may slow decision-making. Most challenging for European leaders could be the signs of increasingly polarised electorates.

Key takeaways

- Support for mainstream pro-European parties has held up, with a significant overall surge in support for populist and Eurosceptic parties failing to materialise.
- The European Parliament will likely end up more fragmented, with the smaller parties – of whatever political persuasion – having a greater influence in alliance-forming.
- Most challenging for European leaders could be the signs that their national electorates are growing increasingly polarised.
- A strong showing by Green parties reflects citizens' increasing focus on climate-related issues and policy – providing a key pointer for ESG investors.
- Looking ahead, sovereign spreads are likely to be the most sensitive to increased political uncertainty and event risk, including snap elections.

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