

(BI) ECB REACT: More Action Is Less With Draghi's Policy Package

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2019-03-07 13:03:56.785 GMT

By Jamie Murray (Economist) and David Powell (Economist) (Bloomberg Economics) -- The Governing Council's decision today shows it's taking the slowdown in the euro-area economy seriously, but the measures fail to offer a material injection of fresh stimulus. If anything, it's a modest reduction compared with current liquidity conditions and market pricing for interest rates.

* The ECB recalibrated its rates guidance today, indicating no rate hike will come this year. With financial markets already pricing in no hike until mid-2020, this does not create additional stimulus. And at the margin, it could even reduce it if investors come to interpret the guidance as meaning the first rate hike will come in 1Q.

* What the rates guidance does insure against is an earlier tightening of financial conditions if the economy beats forecasts this year.

* The ECB also announced a third round of targeted longer-term refinancing operations (TLTRO). However, the terms are less favorable than the TLTRO II loans. The new maturity will only be two years. Previously, the funds were available for four years. In addition, the cost of borrowing will be indexed to the main refinancing rate. That now stands at 0%. Previously, it could have been as low as the deposit rate, which is currently -0.4%.

* In addition, it seems the new loans won't completely replace the funding provided by the old ones. The next lending operation won't be launched until September. However, in order to meet regulatory requirements for their net stable funding ratios, banks need to have funding with a maturity of at least one year. That means fresh funds from the ECB won't be available in June to replace the loans expiring in June of next year.

* Even though a big dose of stimulus is absent, we think GDP growth will begin to pick up in any case and that the labor market will continue to tighten.

* Assuming no big shock from trade policy, Brexit or a re-escalation of tension between Rome and Brussels, conditions should be right for the first rate hike in March 2020 -- our forecast is unchanged on today's announcement.

BE's Short-Term Euro-Area Forecasts

Medium-Term Forecasts

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