ECB Review: September 2020

MNI Point of View:

The September ECB monetary policy meeting played out largely as expected with no changes to monetary policy, a restatement of the ECB's intention to monitor the exchange rate but not target it, minimal changes to staff macroeconomic forecasts and no more than an acknowledgement of the Fed's recent adoption of average inflation targeting.

Nonetheless, markets were arguably expecting a little more. The ECB was not expected to adjust monetary policy to counter recent euro strength, but in the end the degree of verbal intervention felt a little soft and appeared to mirror Philip Lane's recent dismissal of the rally as little more than a 'repricing'. Despite indicating the likelihood of inflation staying in negative territory in the short term, President Lagarde warned against extrapolating from individual data points and gave no indication that additional easing was in the pipeline. Finally, although the forecast adjustments may have been modest and indicate that the baseline scenario remains in play, they nonetheless reflect a slight scaling back of the more downbeat assessment in June.

Overall, the press conference suggested that while there remains heightened economic uncertainty and risks are tilted to the downside, the ECB does not feel a pressing urgency to do more at this stage. In other words, the GC decisions and communication feels slightly less dovish compared to the June meeting, while still pointing in the direction of sustained monetary accommodation. Expectations are higher for the December meeting when the ECB will have greater visibility on the strength of the economic recovery (and possible regional divergences) and staff macroeconomic projections will be updated alongside the new forecasts for 2023.

Analyst Reviews:

ABN AMRO

- The ECB struck a mixed tone in its press conference.
- The commitment to adjusting all policy tools as necessary including full use of the PEPP envelope, ensuring that inflation moves towards target in a sustained manner, and the direct reference to recent exchange rate strength were dovish. However, countering this was the lack of discussion on expanding the PEPP envelope, the slight upward revision to core inflation forecast for next year and the downplaying of recent inflation numbers.
- ABN AMRO continue to expect a EUR500bn increase in the PEPP envelope by the end of the year.
- Given the sharp increase in liquidity and fall in money market rates, the tiering multiplier will likely be increased in the coming months.

Barclays

- As expected, the strength of the euro was discussed. Commentary on the euro appeared in the introductory statement, which is unusual.
- Although the language on the euro was softer than market participants were expecting, it is still a significant step for the ECB. Barclays believes that further euro appreciation could be a possible trigger for more policy accommodation, including through a further rate cut.
- A second recalibration of the PEPP will be announced either at the December meeting, or at the latest in March 2021.

Berenberg

- That the ECB did not change monetary policy was as expected.
- Refraining from signalling further stimulus surprised the market and underpinned the run up in EURUSD.
- The verbal intervention with respect to recent EUR strength was softer than previous occasions when the euro has appreciated significantly over a short period.
- The ECB's forecast adjustments seem to suggest limited disinflationary pass-through from the stronger euro to demand and prices.
- The 1.3% inflation forecast for 2022 remains the lowest projection for medium-term inflation since December 2014.
- Given the 2023 projections published in December are unlikely to show inflation returning to target, Berenberg expects the ECB to raise the PEPP envelope by a further EUR250-500bn.
- Less likely, the ECB could increase the APP by EUR20bn/month to EUR30bn/month.
- The less dovish than expected communication at the September meeting increases the risk that the ECB sits on the sidelines for longer.
- The ECB could take further measures going forward including raising the tiering multiplier and lowering the effective lending rate for its TLTROs (although a further deposit rate cut is unlikely).
- The ECB is unlikely to adopt a Fed-style average inflation target at the end of the strategic review.

Danske

- The outcome of the September meeting was in line with expectations.
- President Lagarde struck a relatively confident tone on the economic outlook and indicated that the GC had not discussed an expansion to the PEPP envelope.
- The fiscal push which underpinned the higher core inflation forecast in 2022 means that the ECB will ultimately rely on other policy areas to achieve the target.
- At present the ECB does not seem too concerned about the impact of the recent euro appreciation on inflation.
- Danske continues to see a global recovery, economic activity at a pre-Covid level by mid-2021, a Brexit resolution and a fairly benign global political situation. This suggests the risks to EURUSD are tilted to the upside ahead of next week's FOMC meeting.

Goldman Sachs

- The limited revisions to the staff macroeconomic projections shows that the baseline outlook remains largely intact.
- President Lagarde indicated little urgency to provide additional monetary accommodation, including through an increase in the PEPP envelope.
- Given that Lagarde offered no details on the policy implications of a stronger euro suggests that the bar for policy rate cuts to counter currency strength is high.
- GS continue to expect that substantial asset purchases will be required beyond the current PEPP envelope given low inflation and increasing bond supply. The base case sees the APP stepped up as the PEPP ends in mid-2021

ING

- Mentioning the exchange rate in the introductory statement for the first time in more than two years and stressing upward revisions of the underlying inflation forecasts could eventually trigger more euro appreciation.
- This suggests that the ECB is concerned by a stronger euro but is not too concerned yet.
- ING continue to expect an extension of PEPP beyond mid-2021, but this is already expected by the market and so the impact on the euro is unlikely to be meaningful.

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Nordea

- The upward revision to this year's GDP forecast likely reflects the positive impact from the EU recovery fund, fiscal easing measures and supportive monetary policy.
- Nordea expects the ECB to expand the PEPP by a further EUR500bn in December alongside an extension to end-2021.
- In addition, new TLTROs will be announced with easier terms, including lower borrowing rates for longer.

RBC

- Lagarde stressed that it's very likely that the PEPP envelope will be used in full, the GC have not discussed an expansion and that the ECB can buy EU bonds once issued.
- The Next Generation EU package received a warm welcome with fiscal support measures expected to address some of the divergences in economic activity.
- The ECB stressed that it was monitoring the exchange rate but will not target it.
- Although the tiering multiplier was not discussed, RBC will expect this to be raised at one of the upcoming meetings.
- President Lagarde indicated that as the strategic review progresses, the ECB could signal the directions in which it was moving.
- The limited adjustments to the macroeconomic forecasts suggest a degree of confidence in the baseline and that measures taken by the ECB are working at intended.
- RBC expect the ECB to continue operating the APP and PEPP beyond the current end date of June 2021.
- At extension and expansion are expected in the future, with December being the first real possibility to do so, which would coincide with the 2023 staff forecasts. The new projections will likely show that the EB is not close to reaching the inflation target over the medium term.
- Ultimately the strategic review will lead to something similar to the Feds average inflation target.

SEB

- President Lagarde sounded surprisingly comfortable with the inflation outlook and provided little indication on the possibility of further easing.
- Given that the ECB did not take into account the EU fiscal package in its June projections, it is not surprising that 2020 growth was revised higher in September.
- Lagarde did not emphasise the need for 'vigilance' with respect to future price developments or indicate a willingness to cut rates further if needed.

TD Securities

- Although there were no changes in monetary policy as expected, the ECB was not as dovish as expected. There was no indication of a potential increased pace of PEPP purchases and the pushback on the rent euro strength was soft.
- The inflation forecast revisions were more upbeat than expected and does not suggest any urgency for further stimulus.
- TD still believes that the risks are tilted to the downside, which could force the ECB to pick up the pace of PEPP purchases later this year.
- TD note that while 2020 growth has been revised higher, the 2021 and 2022 forecasts were revised lower, which is when the bulk of the EU recovery fund money will be disbursed. This suggests that the fund is not a game changer for the recovery.

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