Eurozone

ECB: See you in September

- **The ECB is maintaining the monetary status quo. The central bank esteems that the Brexit victory increases the downside risks to European growth, but that it is still too early to assess the precise effect.**
- **Mario Draghi gives a rendezvous in September when the ECB will present its updated macroeconomic projections. M. Draghi reiterated the ECB's "readiness, willingness ability" to act if needed, emphasising the availability of all instruments within its mandate.**
- **The press conference was dominated by questions on the parameters of the Public Sector Purchase Programme (PSPP) and the situation of banks, notably in Italy.**
- **Without going into detail, M. Draghi said the central bank had shown flexibility so far in meeting its monthly purchasing targets.**
- **As to the Italian banks, M. Draghi said he was in favour of a public backstop under exceptional circumstances to avoid fire sale, while letting the decision up to the European Commission**

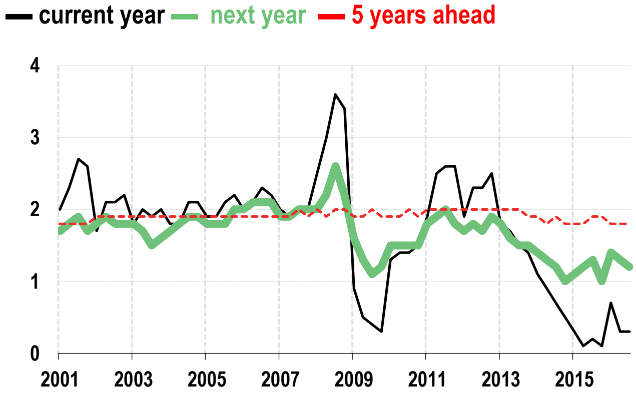
After the Bank of England last week, the European Central Bank (ECB) maintained the monetary status quo at its July monetary policy meeting. While acknowledging that the Brexit victory in the UK referendum creates downside risk for the eurozone recovery, Mario Draghi said it was still too early to fully assess the effects and to draw the right conclusions for guiding monetary policy. He also noted that the financial markets have shown "encouraging resilience" to the shock while underscoring the key role of the announced readiness of central banks to provide liquidity.

Announcements of monetary policy changes are likely to take place in September, when the ECB presents its updated macroeconomic projections until 2018. In the meantime, a series of economic data and survey covering the summer months will provide a more precise idea of the first repercussions the UK "leave" vote will have on the eurozone economy. Earlier this week, the European Commission published its preliminary estimate of the impact, which calls for growth to slow between 0.25 and 0.5 points by 2017. This estimate must be taken cautiously said M. Draghi, however, as it is hard to measure the impact of uncertainty arising from the more or less lengthy negotiations between the UK and the EU. In any case, those negotiations will not begin until the UK government officially notifies the European Council of its intention to leave the EU, which could take several months.

As to inflation, M. Draghi pointed out that, unlike market expectations, surveys of professional forecasts do not show any material signs of a downturn in inflation expectations due to Brexit so far. Nevertheless, the expected downward revisions of growth forecasts are bound to have an impact on prices dynamics. Although headline inflation should automatically rise as of year-end 2016 due to the base effects of energy prices, core inflation (excluding energy and food items), the most pertinent measure from a medium-term perspective, could be revised downwards. Under this scenario, the central bank would probably announce stronger monetary support. M. Draghi reiterated the ECB's "readiness, willingness ability" to act if needed, emphasising the availability of all instruments within its mandate. Our forecast is an extension by six months of the asset purchases programme, which would run through September 2017 at the earliest.

Survey of Professional Forecasters

Inflation expectations



Graphique Source : ECB

The press conference was dominated by questions on the parameters of the Public Sector Purchase Programme (PSPP) and the situation of banks, notably in Italy. After repeatedly stating that the PSPP parameters had not been discussed by the Governing Council, M. Draghi did point out that the ECB had been able to exploit the existing flexibility of the programme so far in order to meet its monthly purchasing targets. As a radical modification of the current distribution key seems unlikely, we think the ECB will be capable of being flexible again in the future, resorting to more substitute purchases (of supranational bonds) in jurisdictions facing a shortage of eligible sovereign bonds, and to fewer such purchases in countries with no scarcity issue.

Lastly, concerning the banks, M. Draghi esteems that the worries concern profitability and not solvency, insisting on the fact that solvency had been strengthened since 2009. As to Italian banks, M. Draghi said he was in favour of a public backstop under exceptional circumstances to avoid fire sale, while letting the decision up to the European Commission.