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ECB: getting ready for more easing, but not in a hurry

■The ECB has eased policy slightly, by extending its forward guidance on policy rates ■On the other hand, the conditions on TLTRO III are slightly less generous than those on the previous operation ■Importantly, a discussion has started within the Governing Council on how to react should the environment worsen ■Understandably, given the eurozone fundamentals, the ECB is not yet in a hurry to react to the prolonged uncertainties. This is a matter of keeping its powder dry

The ECB is getting ready for more policy easing but is not in a hurry. That seems to be the takeaway from Mario Draghi's press conference. 'More', because there was the unanimous decision of some extra easing with the extension of the forward guidance (policy rates are now expected to remain at their present levels at least through the first half of 2020).

On the other hand, markets considered that the ECB underdelivered on the conditions of the new targeted longer-term refinancing operations, which were less generous than the previous one[1]. In addition, it poured cold water on the idea of tiering[2] by stating that "*at this point in time, the positive contribution of negative interest rates to the accommodative monetary policy stance and to the sustained convergence of inflation is not undermined by possible side effects on bank-based intermediation*"[3]. On balance, the euro strengthened against the dollar and bond yields increased slightly.

The market reaction shouldn't come as a surprise: investors love policy easing because, all else being the same, it triggers an asset price appreciation. Moreover, hints by Jerome Powell of possible Fed rate cuts in reaction to the trade-related headwinds, may have fuelled hopes that the ECB might already start to act in such a way. The observation that it is not in a hurry isn't a surprise either. Although manufacturing is suffering, the services and construction sector show resilience and the eurozone economy should continue to benefit from supportive fundamentals. Another reason is the observation that, despite the rhetoric about what the toolkit still offers, room to ease further is far smaller than before: when you have fewer bullets, better aim right. Yet, the most interesting part of the press conference was the comment that the discussion in the Governing Council about the readiness to act in case of adverse contingencies has become more granular with several members raising the possibility of further rate cuts, restarting the asset purchase programme (QE) or a further extension of forward guidance. The inflation front is not different from the world of military affairs: if you want peace, prepare for war, and start sufficiently early.

EUR/USD AND 2-YEAR GERMAN YIELD
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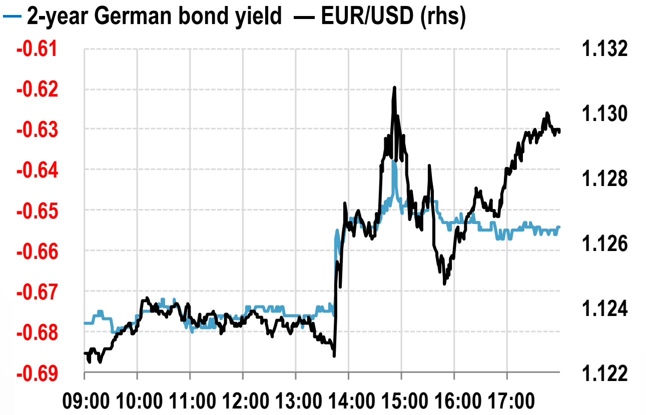

Source: Bloomberg, BNP Paribas

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[1] In TLTRO III, for banks which sufficiently increase their eligible net lending, the rate can be as low as the rate on the deposit facility plus 10 basis points. In TLTRO II the rate could be as low as the deposit facility rate.
[1] Under a tiered system, different rates would apply for excess reserves deposited by banks with the central bank. Part of the reserves could even be exempted.
[1] Source : ECB, Introductory statement to the press conference of Mario Draghi, President of the ECB and Luis de Guindos, Vice-President of the ECB, Vilnius, 6 June 2019

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