

ECO FLASH

13 September 2019

ECB: its target must be reached

Louis Boisset

- The ECB delivered a strong message. The eurozone monetary authorities announced the implementation of a new series of monetary easing measures that went beyond expectations.
 - The Frankfurt-based central bank largely wielded its policy tools by strengthening forward guidance, lowering the deposit rate, easing long-term lending conditions for banks and reactivating net securities purchases.
 - Although the effectiveness of such measures remains uncertain, the ECB's proactive approach was welcomed.
 - Aware that certain policies could have some perverse effects, the central bankers are now demanding that governments use fiscal policy to pick up the slack for quite some time to come.
- The conditions for targeted longer-term refinancing operations (TLTRO) granted to eurozone banks would be improved by notably lowering rates;
 - The deposit rate applied to excess bank reserves would be reduced to -0.5% (from -0.4%) and a tiering system would be introduced. This system exempts part of bank reserves from negative interest rates in order to limit the negative impact on interest margins;
 - Net assets purchases will be reactivated as part of Quantitative Easing (QE), with an amount of EUR 20 bn per month starting in November 2019, for a duration as yet to be determined. These purchases will swell the ECB's balance sheet again, which now accounts for about 40% of the eurozone's GDP, thereby maintaining downward pressure on eurozone long-term rates.

A very proactive package of measures

The focal point of numerous discussions and debates over the summer months, the ECB's monetary policy took a new expansionist turn on Thursday, 12 September 2019. The ECB has proven to be rather aggressive. Since the now-famous Sintra speech of mid-June, and July's monetary policy meeting, the ECB, through the voice of its President, has done all it can to respect its commitments as part of its mandate.

Still a far cry from its target of "medium-term inflation of less than but close to 2%", and despite the manifest reticence of certain governing council members, the ECB announced several strong measures:

- Forward guidance would be strengthened by ruling out any rate increases until inflation had "robustly" converged towards its 2% target. The communication explicitly refers to the core inflation component;

Seen strictly from the angle of respecting its price inflation target, Mario Draghi said the ECB had to act now. Some critics pointed out the potentially negative impact of persistently low or negative interest rates on the profitability of the banking sector and on capital allocation.

Forecasts have been revised downwards

Unconventional monetary policy measures have had a positive macroeconomic effect. Without these measures, GDP growth and inflation would have been lower¹. The uncertainty currently undermining the eurozone is largely stemming from external sources. Under this environment, the announced measures might not be as effective as they were during previous monetary easing phases.

¹ Speech by Philip R. Lane, "Monetary policy and below-target inflation", Bank of Finland, July 2019

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Macroeconomic forecasts by ECB teams were also globally revised downwards (see table below). GDP growth was lowered by 0.2 point to +1.2% in 2020, but remains unchanged at +1.4% in 2021. The 2020 inflation forecast is much lower than in the June scenario (+1%, down from +1.4%) but increases significantly in 2021, to +1.5%. The core inflation component rises to 1.5% in 2021, which is down slightly compared to the June forecast.

Highlighting the press conference was Mr. Draghi renewed call on the governments which had fiscal leeway to use fiscal policy more actively. In this respect, the new phase of monetary easing continues to provide fiscal policy with a particularly comfortable interest rate environment.

ECB Macroeconomic projections (september 2019)

	Real GDP		Inflation		Core Inflation*	
	sept-19	June-18	sept-19	June-18	sept-19	June-18
2019	1,1	1,2	1,2	1,3	1,1	1,1
2020	1,2	1,4	1,0	1,4	1,2	1,4
2021	1,4	1,4	1,5	1,6	1,5	1,6

*excluding food and energy prices

louis.boisset@bnpparibas.com



GROUP ECONOMIC RESEARCH

William De Vijlder
Chief Economist

+33 1 55 77 47 31 william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

Jean-Luc Proutat

Head – United States, United Kingdom

+33 1 58 16 73 32 jeanluc.proutat@bnpparibas.com

Hélène Baudchon

France – Labour markets

+33 1 58 16 03 63 helene.baudchon@bnpparibas.com

Louis Boisset

European Central Bank watch, Euro area global view, Japan

+33 1 57 43 02 91 louis.boisset@bnpparibas.com

Frédérique Cerisier

Euro area (European governance and public finances), Spain, Portugal

+33 1 43 16 95 52 frederique.cerisier@bnpparibas.com

Catherine Stephan

Nordic countries – World trade – Education, health, social conditions

+33 1 55 77 71 89 catherine.stephan@bnpparibas.com

Raymond Van Der Putten

Germany, Netherlands, Austria, Switzerland – Energy, climate – Long-term projections

+33 1 42 98 53 99 raymond.vanderputten@bnpparibas.com

Tarik Rharrab

Statistics

+33 1 43 16 95 56 tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon

Head

+33 1 42 98 56 54 laurent.quignon@bnpparibas.com

Laure Baquero

+ 33 1 43 16 95 50 laure.baquero@bnpparibas.com

Céline Choulet

+33 1 43 16 95 54 celine.choulet@bnpparibas.com

Thomas Humblot

+ 33 1 40 14 30 77 thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure

Head

+33 1 42 98 79 82 francois.faure@bnpparibas.com

Christine Peltier

Deputy Head – Greater China, Vietnam, South Africa

+33 1 42 98 56 27 christine.peltier@bnpparibas.com

Stéphane Alby

Africa (French-speaking countries)

+33 1 42 98 02 04 stephane.alby@bnpparibas.com

Sylvain Bellefontaine

Turkey, Ukraine, Central European countries

+33 1 42 98 26 77 sylvain.bellefontaine@bnpparibas.com

Sara Confalonieri

Africa (Portuguese & English-speaking countries)

+33 1 42 98 43 86 sara.confalonieri@bnpparibas.com

Pascal Devaux

Middle East, Balkan countries

+33 1 43 16 95 51 pascal.devaux@bnpparibas.com

Hélène Drouot

Korea, Thailand, Philippines, Mexico, Andean countries

+33 1 42 98 33 00 helene.drouot@bnpparibas.com

Salim Hammad

Latin America

+33 1 42 98 74 26 salim.hammad@bnpparibas.com

Johanna Melka

India, South Asia, Russia, Kazakhstan, CIS

+33 1 58 16 05 84 johanna.melka@bnpparibas.com

CONTACT MEDIA

Michel Bernardini

+33 1 42 98 05 71 michel.bernardini@bnpparibas.com



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Prepared by Economic Research – BNP PARIBAS

Registered Office: 16 boulevard des Italiens – 75009 PARIS

Tel: +33 (0) 1.42.98.12.34 – Internet :

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