

Macro Focus

ECB update: Deeper into the wicked woods

- ▶ Lower rates, open-ended asset purchases, adjusted forward guidance and TLTRO-III
- ▶ This will have limited impact on economic growth and inflation

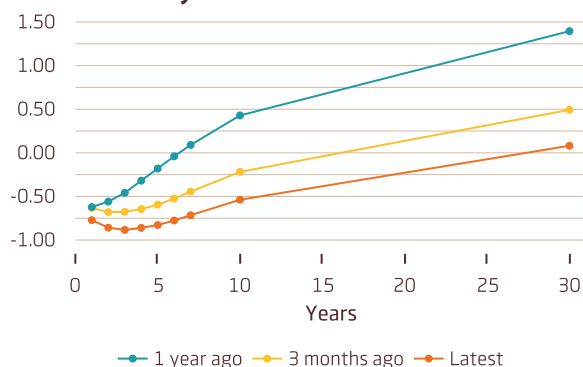
The Governing Council of the ECB took the decision to cut the interest rate on the deposit facility by 10 basis points to -0.50%. The interest rate on the main refinancing operations and the rate on the marginal lending facility remains unchanged at their current levels of 0.00% and 0.25% respectively. The Governing Council also adjusted its forward guidance regarding interest rates. It now expects the key ECB interest rates to remain at their present or lower levels "until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics". As expected, lower rates are accompanied by a two-tier system for reserve remuneration, in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate. In ECB's view this should support the bank-based transmission of monetary policy. The TLTRO-III conditions were adjusted and will be more favorable – the interest rate in each operation will now be set at the level of the average rate of main refinancing operations over the life of the respective TLTRO.

Despite the numerous doubts expressed by quite a few Governing Council members, net purchases will be restarted under the asset purchase programme (APP) at a monthly pace of €20 billion as from 1 November. Although this was slightly less than expected by the markets, this was compensated by the open-endedness of these asset purchases. The Governing Council expects them to run "for as long as necessary to reinforce the accommodative impact of its policy rates". Reinvestments of the principal payments will continue in full. Following the announcement, the euro weakened and government bond yields declined. There was unanimity that fiscal policy should become the main instrument, but there was no unanimity regarding APP – something that Mr. Draghi tried to downplay.

We think that this will have very limited impact of economic growth and inflation in euro area and will have negative side-effects. This was probably the final delivery of the current ECB president Mario Draghi and the next meaningful changes will be done by the incoming president Christine Lagarde. We forecast that the next ECB decision will be monetary policy tightening, not easing. But that won't happen anytime soon.

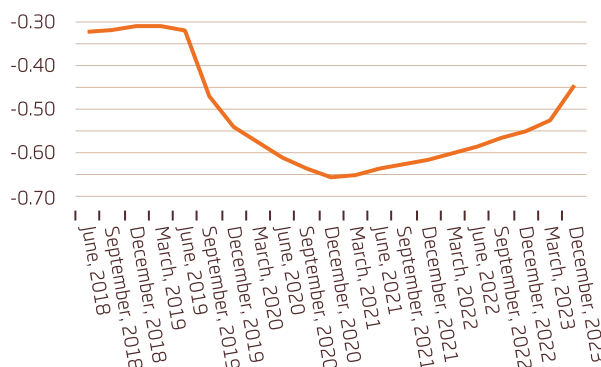
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German bund yield curve



Sources: Swedbank Research & Macrobond

3 month Euribor futures



Sources: Swedbank Research & Macrobond

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