



Active is: Anticipating what's ahead

The ECB is ready to take action

by [Franck Dixmier](#) | 17/06/2019  



Summary

The ECB's next meeting on 25 July is of major importance, and markets should welcome confirmation of its new forward guidance. We expect the central bank to reaffirm that it has the will to support growth and manage inflation, and the tools needed to take action.

Key takeaways

- At the ECB's next meeting, we expect confirmation of the statements Mario Draghi made in Sintra on 18 June: the central bank is ready to take all measures to support growth and move closer to its inflation target, and will likely provide new forward guidance
- We do not expect any concrete action until the ECB's September meeting, which should open a sequence of lower deposit rates followed by the launch of an asset-purchase programme at the end of the year
- The official confirmation of this new forward guidance should be welcomed by the markets, and should help anchor rates at extremely low levels
- We have entered an undeclared currency war

Mario Draghi's speech at the European Central Bank Forum in Sintra, Portugal, on 18 June was a major turning point in euro-zone monetary policy. The ECB's president clearly stated that the bank is willing to take all necessary measures to preserve growth and move closer to its inflation target of 2%. These statements led to a rally in all markets, a flattening of the yield curve, and a tightening of peripheral and credit spreads.

Since then, the underlying context for Mr Draghi's statements has changed little:

- Commercial tensions are stronger than ever.
- The risk of a hard Brexit is still likely.
- Inflation remains anaemic. Despite a slight rebound in core inflation in June – to 1.1% year over year, up from a low point in May – it is expected to move around 1% in the coming months.
- Growth slowed in the second quarter.
- Inflation expectations remain low.

In addition, Olli Rehn, a member of the governing council of the ECB and governor of the Bank of Finland, has since reaffirmed Mr Draghi's positions, confirming the need to respond to a macroeconomic slowdown in the euro area. He has also mentioned the tools available to the ECB, namely a lower deposit rate and a new asset-purchase programme.

The ECB's next meeting on 25 July is therefore of major importance. By validating the previous announcements, now endorsed by the governing council, the ECB should confirm the modification of its forward guidance. The bank should therefore prepare the ground for its next concrete measures: in our scenario, a 10-basis-

point drop in the deposit rate in September and a restart of the securities-purchase programme at the end of the year. The introduction of a multi-tier deposit facility, which was mentioned at the beginning of the year, could come back to the discussions. With the profitability of euro-zone banks being eroded by what is effectively a tax on their excess reserves, a multi-tier deposit facility similar to the one set up by central banks in Switzerland, Japan, Denmark and Sweden could be a viable option. Under this scheme, the taxation of banks' excess reserves would be triggered above a threshold that is specific to each institution.

On 25 July, it will also be interesting to observe whether the new measures envisaged are unanimously agreed within the governing council: possible dissension within could weaken the scope of the message. However, the recent announcement of the change in leadership at the ECB – the expected appointment of Christine Lagarde as the ECB's next president – should not affect the strategy the central bank follows.

For investors, the 25 July meeting is expected to have little impact. Even if nearly half of market participants expect a reduction of 10 basis points in July and 15 basis points by the end of the year – and therefore might be disappointed by the ECB maintaining the status quo – the official confirmation of even more accommodative monetary policy should be well-received, and should anchor rates at extremely low levels.

It should be noted, however, that we have entered a phase of an undeclared currency war. Despite Mr Draghi's denials in Sintra, it is clear that the impact of expected US rate cuts on the US dollar is an element the ECB should take into account, despite the fact that the ECB has no exchange-rate target. As the European economy slows and inflation falls, an appreciation of the euro would not be appropriate, in our view. Undoubtedly, the evolution of the ECB's monetary policy will fuel accusations by US President Donald Trump that the euro is being manipulated to support growth in the euro zone; this will likely fuel disputes between the euro zone and the United States.

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by [Franck Dixmier](#) | 17/06/2019  



Summary

Markets are keenly awaiting the next monetary policy meeting of the US Federal Reserve, which will take place on 18 and 19 June.

Key takeaways

- The Federal Open Market Committee meeting comes as the US Federal Reserve (Fed) is under constant pressure from the markets and the White House
- Even if the Fed's next move should be a rate cut, at this stage it seems unlikely that this decision will be announced as early as 19 June
- Market disappointment could lead to a rate correction, which should encourage investors to take longer duration exposure in their US bond portfolios

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