

ECB Preview – Thursday 12th March

This week's ECB decision brings Christine Lagarde's first real test as President, with policymakers having to face dealing with the external, sudden shock of the coronavirus with an exhausted policy arsenal amid questions over the efficacy of monetary policy in tackling the epidemic.

What's on Lagarde's Plate?

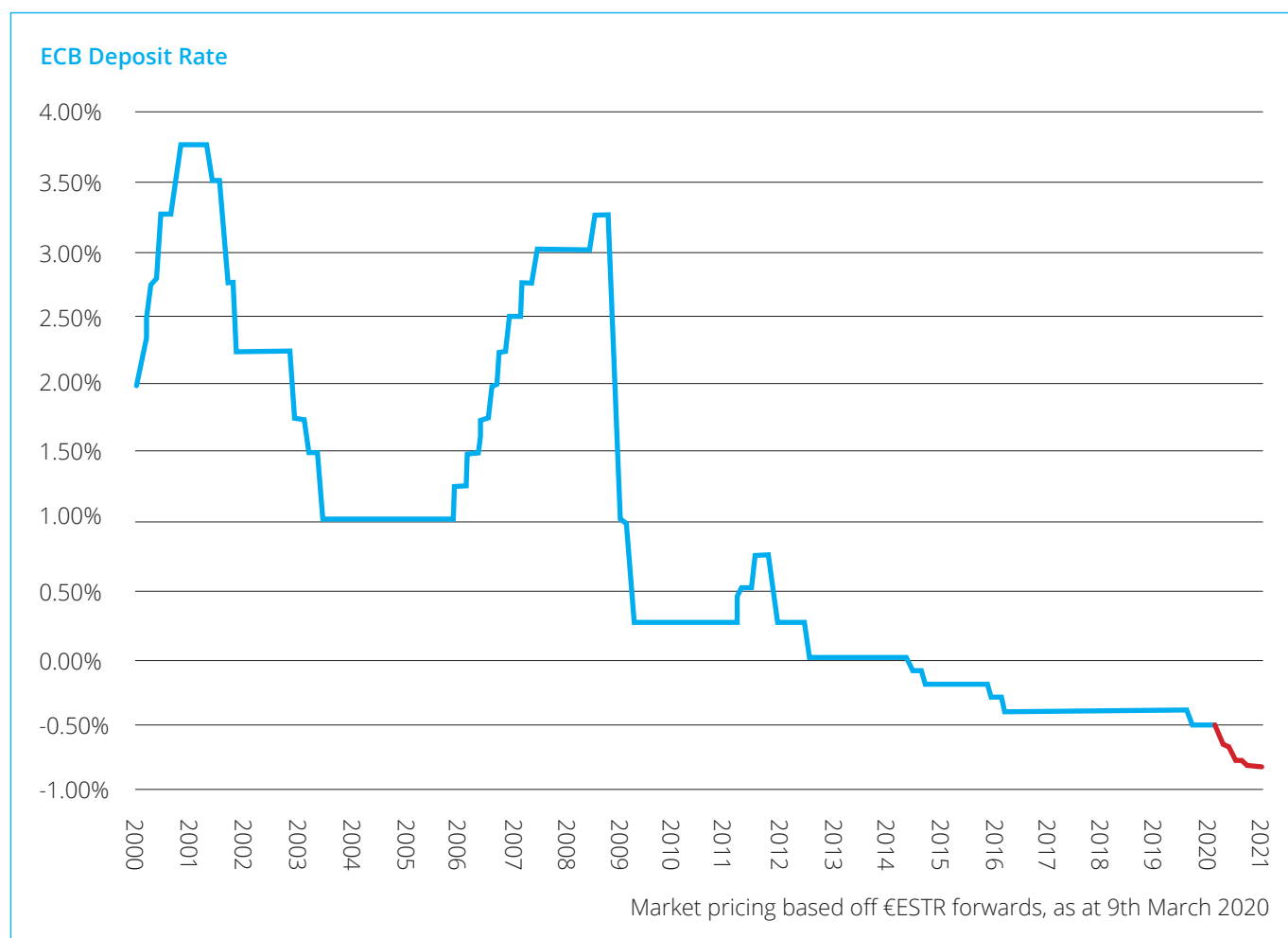
The Governing Council (GC) of the ECB go into the meeting facing a multitude of issues, chief among which obviously being the coronavirus epidemic and the turmoil that the fast-moving epidemic is wreaking on markets.

Meanwhile, the GC will also need to consider the ongoing sluggish economic momentum plaguing the bloc, a continued benign pace of inflation (and longer-run inflation expectations falling below 1%), the tail risk of a WTO Brexit, and the prolonged negotiations over the EU's latest 7-year budget.

All of this comes as markets price in an aggressive path of policy easing, and as policymakers fly blind into the meeting, with the latest staff macroeconomic projections having been compiled before the full extent of the coronavirus epidemic in Europe became clear.

What's Priced In?

As mentioned, markets price an aggressive path of policy easing from the ECB, including three 10bps deposit rate cuts by the end of the year.



What Can Policymakers Do?

Expectations, as shown above, are high going into the policy decision, with markets expecting the announcement of a significant stimulus package. Some of the options likely to be under consideration by the GC include:

- **10bps Deposit Rate Cut**

The ECB will likely deliver on the market's pricing of a 10bps rate cut, taking the deposit rate deeper into negative territory, and to a fresh record low of -0.60%. However, the efficacy of blanket rate cuts in dealing with the twin supply-demand shock of the virus is questionable at best.

- **Forward Guidance**

It is difficult to see how policymakers could make the present forward guidance – that rates will remain 'at present or lower levels' until inflation 'robustly converges...close to but below 2%' – more dovish, given its already 'state based' nature, hence the guidance is likely to remain unchanged

- **Quantitative Easing**

The ECB are already making net purchases of €20bln per month under the asset purchase programme, a pace which is likely to be increased in an attempt to stimulate the bloc's economy. There are, however, two issues with this. Firstly, an increase in purchases of government bonds would quickly run into self-imposed issuer limits. Secondly, with yields across the bloc – and across durations – already deep in negative territory, the impact of a sizeable increase to the QE programme is doubtful

- **TLTROs**

The ECB's ongoing targeted longer-term refinancing operations have seen relatively subdued take up thus far, however an expanded TLTRO programme appears to be the perfect solution to the potential liquidity crunch caused by the coronavirus. An expanded or more generous TLTRO programme is likely, and is the sort of targeted measure that would help the coronavirus-stricken eurozone economy recover

- **Fiscal Stimulus**

While not within the ECB's remit, policymakers are likely to repeat – and likely place even greater emphasis on – the need for co-ordinated, targeted, fiscal stimulus from eurozone governments

Possible Scenarios

HAWKISH SURPRISE	DOVISH BASE CASE	'WHATEVER IT TAKES' PT. 2
Rates: Unchanged (Refi 0.0%, Depo -0.5%)	Rates: 10bps depo cut to -0.6%, Refi unch	Rates: 10bps depo cut to -0.6%, Refi unch
Forward Guidance: Unchanged	Forward Guidance: Unchanged	Forward Guidance: Explicitly mentions growth as well as inflation
QE: Unch €20bln per month	QE: Increased to €40bln per month	TLTRO: Rate cut by 20bps, maturity extended
TLTRO: Unchanged	TLTRO: Rate cut by 10bps, maturity extended	Fiscal: Greater push for co-ordinated E/Z package
Fiscal: Places the burden back on governments to stimulate the E/Z	Fiscal: Greater push for co-ordinated E/Z package	
% Likelihood: >5%	% Likelihood: 80%	% Likelihood: 15%

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Whilst it is unclear exactly what the ECB will do, one thing we can be certain of is the ongoing volatility caused by Coronavirus within the FX markets. It is at times like these that you need to work with an expert.

Please feel free to call us on **+44 (0) 207 042 7629** to discuss the implications of the ECB meeting.