GIAM Macro & Market Research - Market Commentary

ECB starts to think about a tiering system amid a dovish policy stance

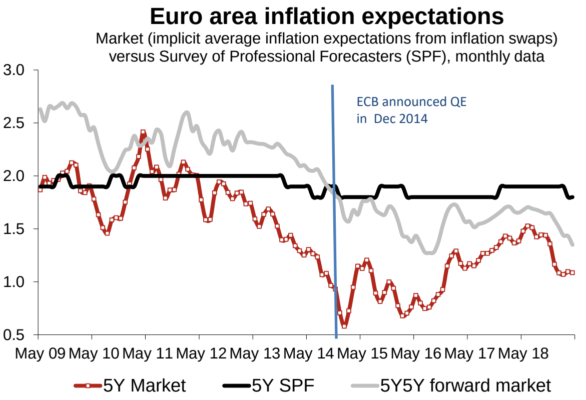
- **At today's meeting the ECB left its forward guidance unchanged as it continued to expect rates to remain at current levels "*at least through the end of 2019*".**
- **Details about the forthcoming TLTROs were not yet provided. They will depend on the assessment of the bank-based policy transmission channel and the further economic development.**
- **Moreover, the ECB will assess the negative economic side effects of negative interest rates.**
- **Draghi maintained a dovish tone at today's press conference. The EUR softened against the USD while 10Y Bund yields receded.**

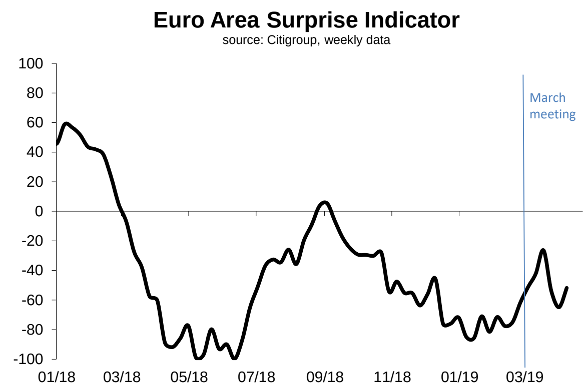
At today's Governing Council meeting, the ECB reiterated that key rates will not be altered at least until year-end 2019 but did not yet become more precise on the design of the TLTROs.

Assessment of macro outlook: After having adjusted its macro outlook to the downside at the last meeting, the ECB saw no need to materially change the assessment. The ECB continues to see the recovery intact and expect idiosyncratic domestic factors to fade but external headwinds to prevail. In sum, the period of economic weakness proved to be "*somewhat longer lasting*" than previously thought. But in the end the ECB continues to expect that "*further employment gains and rising wages continue to underpin the resilience of the domestic economy and gradually rising inflation pressure*". As at the last meeting, the activity risks remain on the downside. That said, the "*estimated probabilities of a recession remain low.*"

No TLTRO details yet: Details of the forthcoming TLTROs have not been discussed. In the accompanying statement, however, the ECB made clear that it "*will take into account a thorough assessment of the bank-based transmission channel of monetary policy, as well as further developments in the economic outlook.*" The details will only be provided in one of the forthcoming meetings. Quite obviously, the reassessment of the macro outlook at the June meeting will be key.

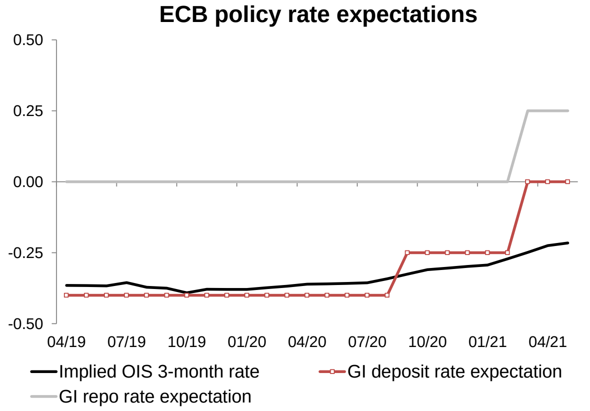
Tiered system might be in the pipeline: Given the long period of negative rates, its negative side effects increasingly come into focus. According to the German Banking Association, euro area banks pay € 7.5 bn on deposits. At today's meeting the Governing Council stated that it will analyze whether this requires "*the mitigation of their possible side effects*". At today's meeting the pros and cons were not discussed but we expect this topic to be put on the agenda in one of the forthcoming meetings. The longer the ECB postpones policy normalization the more pressing this topic becomes.

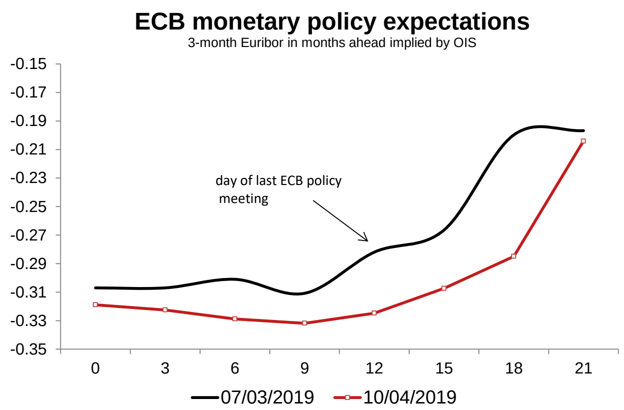




ECB maintained easing bias: Since the March meeting, markets have revised their key rate expectations to the downside. Before today's ECB policy meeting markets saw only a 26% chance of a 15 bps depo rate hike by September 2020 and a 44% one for December 2020. At today's meeting, the ECB left its forward guidance on rates (constant at least until the end of 2019) and put the statement that "*the Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner*" more prominently. Moreover, he adopted a dovish tone. We feel supported in our view that the APP reinvestment period will last for three years (until the end of 2021) and that a first depo rate hike will not come before September 2020.

Market reaction: Markets perceived the ECB as dovish. The EUR softened against the USD while 10Y Bund yields receded slightly.





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