DBS Flash

Eurozone: ECB to stay dovish "as long as necessary"

Economics/Growth/Monetary/Rates/India

DBS Group Research

September 13, 2019

Radhika Rao
Economist

Philip Wee
FX Strategist

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *The European Central Bank cut deposit facility rates, introduced a tiering system for banks and kickstarted QE on Thursday*
- *Inflation and growth projections were lowered*
- *Open ended nature of the QE might need a review of investment ceilings*
- *Outgoing ECB chief (second last meet) called on governments will fiscal space to act*

From "whatever it takes" to "as long as necessary," outgoing European Central Bank chief Mario Draghi followed up with his promise of delivering monetary stimulus on Thursday. This marks the second last policy review of his term. The decisions were backed by a majority in the Council but was not unanimous.

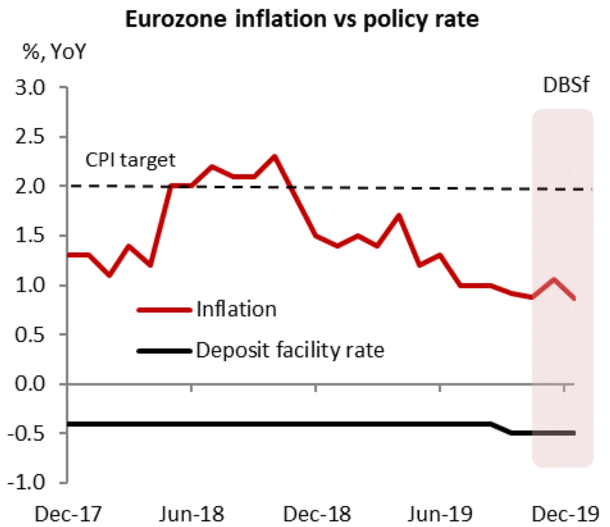
Economic assessment: Reflecting the Governing Council's concerns, growth and inflation projections were lowered. 2019 GDP is now seen at 1.1%, 2020 at 1.2% and 2021 at 1.4%, effectively lowering 2019 by 10bps and 2020 by 20bps compared to June.

Inferring from ECB's comments, the baseline assumptions factor in an orderly Brexit and non-escalation in trade wars. Inflation was also dialled down to 1.2% in 2019, 1% in 2020 and 1.5% in 2021 (vs June's 1.3%, 1.4% and 1.6% respectively).

Policy decision: Citing the weak economic outlook, benign inflation trajectory and urgency to re-anchor inflationary expectations, key measures included:

- Open-ended forward guidance, not to be calendar year based
- Cut the deposit rate by 10bp to -0.5%
- A tiering system where the exempt tier is remunerated at 0% and applies to reserve times six. Multiplier and rates can be changed over time
- Asset purchases will be restarted at EUR20bn, starting from November, without the mention of any end-date.
- The third tranche of Targeted Longer-Term Refinancing Operations (TLTRO) will be repriced and incentivized for banks to lend.

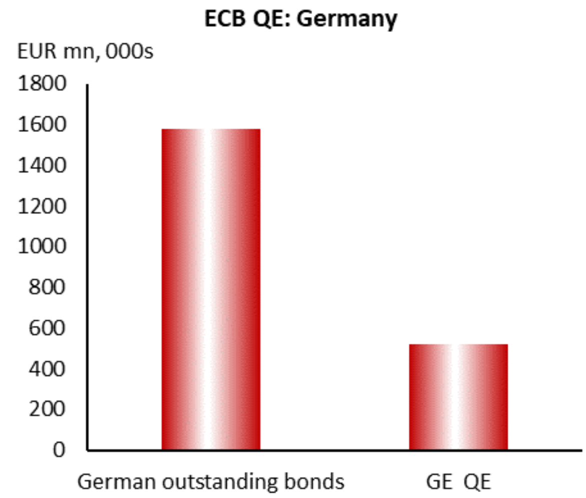
Maturity of these loans have been extended to three years.



Source: CEIC, DBS

Policy outlook: The combination of measures announced on Thursday largely delivered on the ECB chief's dovish guidance. Draghi also pushed through against significant opposition, particularly on restarting QE. We note that the latter has been left open-ended, but without any changes in the underlying thresholds, namely the 33% cap on the member countries, amongst others. This suggests that to be materially 'open-ended, a review of the thresholds might be necessary within a year.

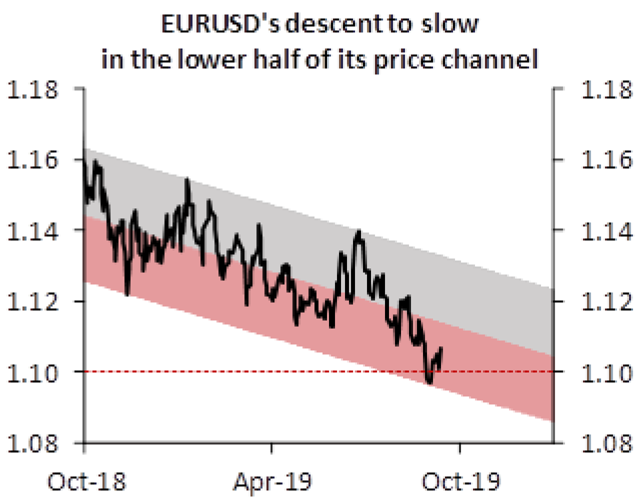
Mr. Draghi was forthright in calling for fiscal stimulus, especially with countries with the 'fiscal space' to act in an effective and timely manner. We recall that incoming ECB head Christine Lagarde has already emphasized that onus of supporting growth cannot be completely borne by monetary policy and fiscal stimulus is also needed.



Source: CEIC, DBS

Financial markets, particularly the EUR/USD, were choppy during the announcements and after the press conference, as markets digested the impact of the announcements. While the ECB delivered on its promises, markets are unlikely to perceive this as enough to materially boost growth and inflation prospects. This backs our DBS FX Strategist's view that growth and rate differentials favour the US vs Eurozone, which will reflect in the respective currencies. This is likely to keep EUR/USD in the lower 1.05-1.10 range this year.

EUR/USD FX Outlook



Sources: DBS Research, Bloomberg data

The US Fed cut expectations have stymied the European Central Bank's stimulus bazooka to push the euro below 1.10 in the short-term. ECB President Mario Draghi delivered an asset purchase programme at his final governing council meeting on September 12. The APP will restart on November 1, when Christine Lagarde takes the reins at the ECB from Mario Draghi, at a pace of EUR20bn per month and end shortly before the ECB starts raising rates. The ECB's forward guidance for rates to stay lower for longer is likely to be extended beyond its mid-2020 guidance based on the downward revisions in its growth/inflation forecasts.

Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Chang Wei Liang
Strategist
+65 6878-2072 weiliangchang@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21-2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying, CFA
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Duncan Tan
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or finan¬cial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.
DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.PT Bank DBS Indonesia, DBS Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000. Company Registration No. 09.03.1.64.96422.