

## GIAM Macro & Market Research - Market Commentary

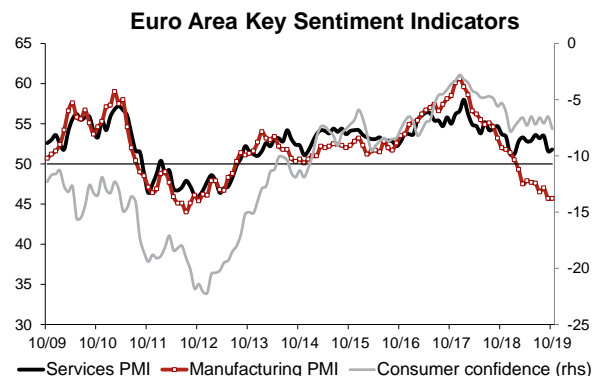
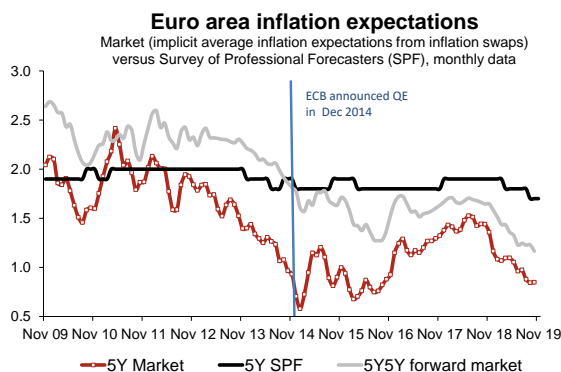
October 24, 2019

### Draghi says farewell and reiterates his call for more fiscal action

- At today's meeting, the Governing Council unanimously decided to not change its policy stance while continuing to see risks on the downside and maintaining a dovish bias.
- Concerns about QE restrictions becoming binding in the new QE program were downplayed but no details about the composition were provided.
- In his farewell press conference President Draghi reiterated his call for stronger fiscal action and talked down the rift within the Governing Council.
- Looking ahead, we expect the ECB to stay on hold for the time being.

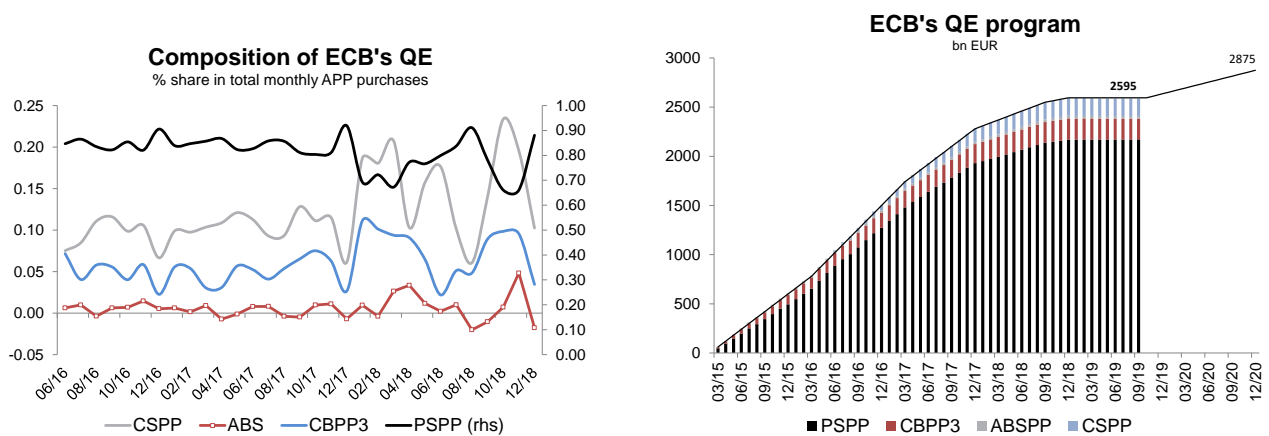
Following the announcement of bold policy action in September, there was no further policy change at President Draghi's farewell meeting. Instead, the outgoing President defended his policy decisions and made clear that for further action the ball was now in the field of fiscal policy.

**Domestic economy still resilient:** At its September meeting the ECB adjusted its macro outlook to the downside. Since then, PMIs took another hit and expectations remained muted. At today's meeting the Governing Council's assessment of activity remained broadly unchanged as domestic activity was still characterized as resilient, albeit acknowledging for some moderation. In the press conference Draghi became clearer by noting that some manufacturing weakness spread to the services sector and that the development of the PMIs justified the decisive September policy action. The risk assessment remained unchanged and in the press conference downside risks were characterized as prominent.



**No details of the new QE program:** Regarding the composition of the ECB's new QE program Draghi stated at the September meeting that "*by and large it's going to be the same we purchased in the past*". In 2018 the average share of corporate bond (to 15%, from 10% before) and covered bond purchases (to 8%, from 5% before) in the monthly operations increased at the expense of mainly PSPP purchases (76%, from 85% before). At today's meeting no further details were provided. However, Draghi tried to dissipate market doubts about the ability to conduct an open-ended QE program. Asked about the issuer limit he stated that it will take quite some time until it is reached and that under reasonable assumptions there was enough time. He also said that the limits were self-imposed, specific to contingencies and that the European Court of Justice granted

flexibility to the ECB. With respect to capital keys, he pointed that this measure referred to the stock and the flow of PSPP purchases. Bottom line: At least in Draghi's view there is enough flexibility to conduct QE for quite some time.

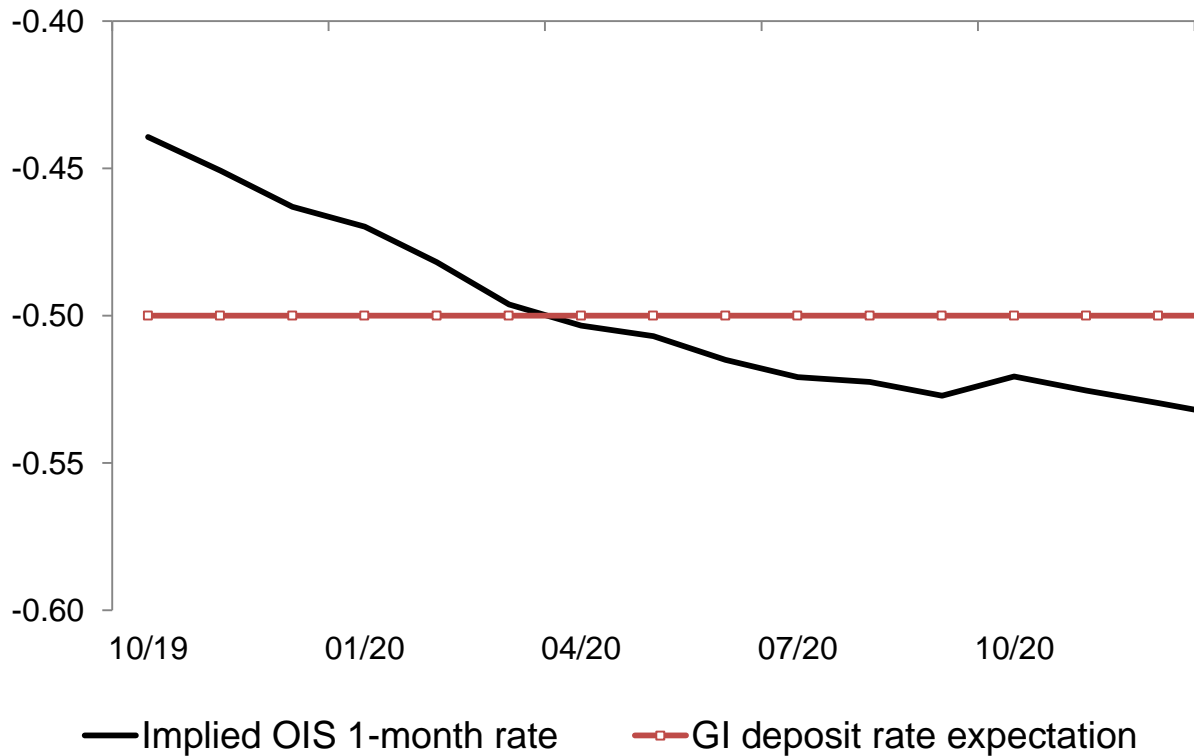


**Call for more fiscal policy as monetary policy is stretched:** In the press conference it became clear that Draghi and the ECB are aware of the negative side effects of the current policy stance, especially negative interest rates – which are continuously being monitored - while again defending the past policy measures. Hence it came as no surprise that as already in the previous meetings, the Governing Council urged fiscal policy to take a more active role while acknowledging the present mildly expansionary fiscal stance. In the press conference Draghi stated that with fiscal policy support the ECB's policy targets could be reached sooner. Moreover, he again promoted the idea of an EMU fiscal capacity.

**Split views in the Governing Council downplayed:** Draghi tried to play down the rift within the Governing Council by emphasizing that today's decision to not change monetary policy went through with unanimity. Also he reported that within the Governing Council there was generally a call for unity. We doubt that the underlying difference on monetary policy vanished but rather interpret this as a general attempt to discuss future differences more internally.

**Dovish tilt but no further policy action imminent:** Given the diverging views on monetary policy within the Governing Council and our increased view that the two major risks (crash Brexit, intensification of trade war) will not materialize we now deem constant ECB policy rates for the time being the most likely scenario. That said, the dovish tilt that Draghi again emphasized will keep the willingness of a further depo rate cut high, should the development be more averse than expected. Looking further ahead, Draghi reported from the latest IMF meeting that the paradigm of central banks has shifted towards low interest rates for a long time. Draghi himself contributed to this significantly over the past years.

## ECB policy rate expectations



**Author:**

Martin Wolburg

[martin.wolburg@generali-invest.com](mailto:martin.wolburg@generali-invest.com)

[www.generali-invest.com](http://www.generali-invest.com)

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