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# A proactive ECB becomes more dovish than markets anticipated



The ECB has surprised observers with a dovish move on monetary policy, extending the time horizon in which it will not raise interest rates and unveiling more cheap funding for banks.

ECB president Mario Draghi and the rate-setting governing council want to forestall a growth slowdown in the EU, with the large German and Italian economies both struggling.

The stronger move than economists had predicted came as the US Federal Reserve and other central banks around the world are also holding back on rate hikes.

What were the decisions taken yesterday?

1. Keep key ECB interests unchanged. A possible rate hike has been pushed out to 2020 at the earliest

2. Keep on re-investing the principal amounts from maturing securities that were purchased during the asset purchasing program that ended in December 2018
3. A third cheap funding scheme for banks, the Targeted Long-Term Refinancing Operation (TLTRO III) consisting of two-year loans to help avoid a squeeze on credit, which could add to the slowdown in Europe. The program starts in September 2019 and ends in March 2021. Further details on the precise terms of TLTRO-III will be communicated later.
4. Continue conducting lending operations as fixed-rate tender procedures with full allotment for as long as necessary

During the following press conference the ECB confirms that the latest economic data has been weaker and they expect the weakness to last through 2019. The risks surrounding the euro area growth outlook are still tilted to the downside, on account of the persistence of uncertainties related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets.

Reactivating the QE program was not mentioned but all options remain open.

Reading the minutes of the meeting we can conclude :

- The inflation target of the ECB will take longer to achieve
- The ECB acknowledges a difficult economic situation and a weak outlook
- The ECB is ready to act and wants to be proactive
- “Japanisation” of the monetary policy is again one step closer

Following the announcement, European bond yield took a dive lower and the German 10Y ended the day at 0,07%, the EURO also weakened by 1% against the USD to 1,12. The reaction on the equity market was initially positive but that was short-lived. The details on the growth and inflation outlook discussed during the press conference pushed equity markets lower again and the STOXX600 closed the day with a loss of 0,43%.

Financials were the underperforming sector yesterday. The EuroStoxx Banks index closed the day at -3.32%. The fact that banks will have to deal with negative interest rates for a prolonged period and a weaker forecasted economic growth were a very negative cocktail for bank stocks.

Our take :

The decision and speech comfort our view on the European economy, which has been more dovish than the consensus for a few months. It also confirms our long-held conviction that the ability of the ECB to “normalize” monetary policy upwards is in fact quite limited by the macro situation. The latter remains a burden for current and expected earnings, and comforts our strategic underweight positioning on European equities.

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