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ECB: Persistently Accommodative

The European Central Bank (ECB) pledges to keep interest rates at record low levels for even longer, saying it will persist with ultra-loose stimulus until it has solid evidence it can sustainably hit its new inflation target.

All eyes were on Thursday's ECB meeting in Frankfurt in order to gauge the implications of its recently-completed policy review on near-term monetary policy. With Christine Lagarde at the helm, the ECB has adopted a new "simple, solid and symmetric" inflation target of 2%[1] , giving it more flexibility to keep policy accommodative as the eurozone emerges from its deepest recession since World War II.

This gave way to dovish messaging at its monetary policy committee, with the central bank underlining "its commitment to maintain a persistently accommodative monetary policy stance to meet its inflation target", even if this means withstanding a temporary overshoot above 2%. Though the ECB has ran with record-low interest rates and bought trillions of euros worth of bonds, eurozone inflation has been stubbornly low, averaging only 1.2% since the great financial crisis. Though it has been rising on the back of the economic reopening, tallying in at 1.9% in June, the ECB expects it to subside to 1.5% next year and 1.4% in 2023.

As it pursues durable price pressures, the ECB said:

- Key interest rates will "remain at their present or lower levels," until eurozone inflation is "sufficiently advanced to be consistent with . . . stabilizing at 2% over the medium term".
- The Pandemic Emergency Purchase Program (PEPP), worth some €1.85 trillion, will continue until at least the end of March 2022 and, in any case, until the ECB judges that the coronavirus crisis phase is over.
- Its regular asset purchase program which runs at €20bn a month will continue "for as long as necessary to reinforce the accommodative impact of our policy rates, and to end shortly before we start raising the key ECB interest rates".

The PEPP was launched in March 2020 at the height of the pandemic and global lockdowns. In fire-fighting mode, the ECB removed many of the overarching constraints that its purchase programs are normally subject to. Since then, it has purchased almost all new issues of eurozone government bonds meaning it now owns around 42% of all sovereign debt in the bloc. Hawkish members of the ECB governing council purport that since the health crisis appears to be drawing to a close as the vaccine rollout ensues, the ECB should give up crisis-era powers and revert back to its traditional modality. However, as of now, the doves have prevailed, arguing that the more-contagious Delta variant is already resulting in renewed restrictions in certain member states, posing a threat to the recovery.

With financial markets not pricing any rate change for at least three years, the impact of today's meeting is currently quite limited.

For investors, the message is that the ECB is set to continue being a whale in the European bond market. Outsized bond-buying programs keep yields artificially suppressed, boosting the relative attractiveness of risk assets like equities. Indeed, after the ECB meeting, European stocks rose for a third day and eurozone government bond yields retreated slightly.

[1] https://www.ecb.europa.eu/press/inter/date/2021/html/ecb.in210713~ff13aa537f.en.html

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