

## ECB: No Change, But Action Likely In March

- **Unchanged today, but we now expect a March rate cut.** The ECB disappointed market hopes of action today, keeping its interest rates, non-standard measures unchanged and not ending SMP sterilisation. But ECB President Draghi opened the door to action in March. He slightly strengthened the forward guidance language by adding that it was 'firmly' determined to maintain the high degree of monetary policy accommodation. He also pointed that the ECB needed more information before deciding whether to act. He said that the ECB would in March provide inflation forecasts until 2016 (so a little more than two years ahead) for the first time, and also would know more about the nature of the EM turmoil. We therefore bring forward the timing of the refi rate cut to March, looking for a 15bp cut in the refi rate (leaving the deposit rate at zero). We still expect the ECB to cut the deposit rate to -10bp in Q2. But we acknowledge that incoming data and news are key. Should the EM turmoil intensify or the February inflation reading undershoot substantially, a negative deposit rate may already be announced in March. Rising money market rates could trigger liquidity measures (e.g. reducing reserve requirements), while higher inflation or stronger credit data could delay any action.
- **'The euro area is different from Japan'.** At the same time, the press conference indicated that no *major* stimulus (such as large-scale QE) was likely anytime soon. Draghi noted that January HICP inflation was lower than expected, but did not see a prospect for deflation, expecting inflation to remain 'low, subdued and close to current levels' in coming months, but to then rise to 'close to, but below 2%'. He noted that inflation risks were balanced, but for the first time also that both upside and downside risks were limited (which we read as indicating mostly limited *upside* risks). But he also extensively discussed why he did not see the Eurozone sliding into deflation. We think Draghi's remarks suggest that the ECB is **too complacent about deflation risks**, even if he saw very low inflation as a 'risk by itself'. Regarding potential asset purchases, Draghi noted that all instruments were available, subject to the Treaty's 'no monetary financing' provision, but said that 'plain vanilla' ABS were very interesting as they could support lending and improve the monetary transmission mechanism.
- **No end to SMP sterilization (yet).** Draghi said that ending SMP sterilisation had not been discussed in the GC meeting, but in the 'relevant committees' and that all measures were available to address the two major contingencies (unwarranted tightening in money markets and a worsening of the medium-term inflation outlook).
- **Credit not as bad as you may think.** Draghi downplayed the poor performance of the credit channel, highlighting that the bank lending surveys showed some stabilisation, and that the rise in corporate bond issuance was almost compensating for the continued contraction in bank lending. He also repeated that credit was a lagging indicator and that the AQR may have weighed on bank lending in Q4.

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