

Economics

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ECB

2012 Starts With No Surprise, ECB Open To Cut Rate Below 1%

- The ECB left the main interest rate unchanged at 1.0%, in line with the consensus and our forecast. The rate for the deposit facility and the marginal lending facility remained unchanged at 0.25% and 1.75% respectively. The decision was unanimous.
- The January press statement was not that different to the December one, expecting a slowdown in economic recovery and a modest recovery in the second half of 2012. While the statement mentioned that there are *"tentative signs of a stabilisation in activity at low levels"*, it repeatedly highlighted that the outlook remains subject to *"high uncertainty and substantial downside risks"*. There was also no change in the view on inflation, expecting a decline to below 2% over the course of the year and inflation to be in line with ECB's target of *"below, but close to 2%"* over the medium term.
- President Mario Draghi did not repeat his predecessor's comments that 1.0% would be a lower bound for rates. Mr. Draghi highlighted that rates would be set in order to achieve price stability over the medium term and that in the current environment monetary conditions would have to stay accommodative. He was explicit in saying that the ECB is ready to act on interest rates if needed.
- The ECB did not announce additional non-standard measures today, but Mr. Draghi welcomed the extensive use of the first 3Y LTRO. It made a substantial contribution to support banks, particularly those facing a large amount of maturing debt in early 2012. He stated that the fact that the banks using deposit facility are not the same as those participating in the LTRO as evidence that the liquidity is starting to circulate in the economy, probably preventing a severe credit contraction. Regarding the banking sector, Mr. Draghi warned that capital increases requested by the EBA stress test could be problematic. Mr. Draghi announced that the further extension of the collateral pool will be available before the next 3Y LTRO on 28 February, which in Draghi's view will also face *"substantial"* demand. Mr. Draghi also made clear that the ECB will continue the SMP for the time being.
- The ECB Governing Council welcomed the EU Council decision on the new fiscal compact, but asked for swift deployment of the rules. Mr. Draghi also repeated the need for the euro area countries to correct excessive deficits and to implement structural reforms. He added that an effective and quick implementation of the EFSF and ESM is urgently needed. Regarding Greece, Mr. Draghi stressed the importance to implement structural reforms and austerity measures. He made clear that he dislikes the PSI for Greece which has created negative consequences, and urged policy makers to make clear that Greek PSI is unique and exceptional.
- **Comment:** Mr. Draghi made clear that the ECB is ready to cut rates, if there are signs of a deeper recession and/or a clear undershooting of inflation below 2% in the medium term. We expect such signs in coming months and see the ECB cutting rates to 0.5% in 2Q, probably in two 25bp steps. We also expect that the ECB will implement additional non-standard measures this year if the situation deteriorates further.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Appendix A-1

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