

Economics

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ECB

Positive on LTROs, Rate Cut in 2Q Looks Now Unlikely

- The ECB left the refi rate unchanged at 1.0%, in line with the consensus and our forecast. According to President Mario Draghi the Governing Council did not discuss interest rate changes at today's meeting.
- The Governing Council did not change its growth outlook compared to the previous month, expecting *"the euro area economy to recover gradually in the course of this year"* and continues (although somewhat less strongly than before) to see *"downside risks"* to growth. The new Staff Projections support that view. However, the downward revision of the mid-point forecast of the staff projection for 2012 GDP growth to -0.1% from +0.3% in December was larger than we expected. The ECB also revised the projection for 2013 down slightly to +1.1% from +1.3%. On the inflation side, the Governing Council no longer expects a fall in inflation rates below 2% in 2012 amid higher oil prices and indirect tax hikes. The Staff revised up the 2012 forecast more than we expected from 2.0% in December to 2.4% now. The 2013 mid-point projection is 1.6%, slightly revised up from 1.5%. The ECB expects price stability in the medium term, but highlighted in the press statement that *"all the necessary tools to address potential upside risks to medium-term price stability are fully available"*.
- The ECB was very upbeat regarding the impact of the 3Y LTROs. While the press statement describes the impact as *"positive"* and helping to contribute to a *"significant improvement in the financial environment"*, in the Q&A session President Draghi said that the 3Y LTROs were an *"unquestionable success"*. He added that an ECB survey among banks suggested that the action would lead to a modest pickup in bank lending. In Mr. Draghi's view, with the LTROs the ECB has taken away tail risk and the ball would now be back in the courts of the governments. While the ECB welcomed governments' actions to implement fiscal consolidation, the stepping-up of structural reforms and the progress on governance (fiscal compact), President Draghi asked governments for further action, including the installation of a large rescue facility.
- The ECB President played down the controversy with the Bundesbank, highlighting that there had been a unanimous Council decision to use the 3Y LTROs. Regarding collateral (described as too generous by Bundesbank President Weidmann), Mr. Draghi said that the use of the extra collateral eligible for the open market operations accepted by seven national Central Banks was just €53bn, out of which about €40bn came from French banks, which were already over-collateralized, and about €3bn from Italian banks. According to President Draghi, the ECB did not discuss a tightening in collateral standards, and he stressed that collateral standards could be much looser. He also repeatedly said that the risk taken by the ECB was manageable.
- Comment: Compared to our economic outlook (GDP: -1.3% in 2012; -0.3% in 2013) the ECB Governing Council and the Staff remain more upbeat, but now have a similar view on inflation. We continue to expect the ECB to cut interest rates to 0.5% in the course of the year, when more signs of economic weakness are likely to emerge, but with a less-relaxed ECB view on inflation, we no longer expect a 25bp rate cut in 2Q.

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