Economic Flash

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March 2016

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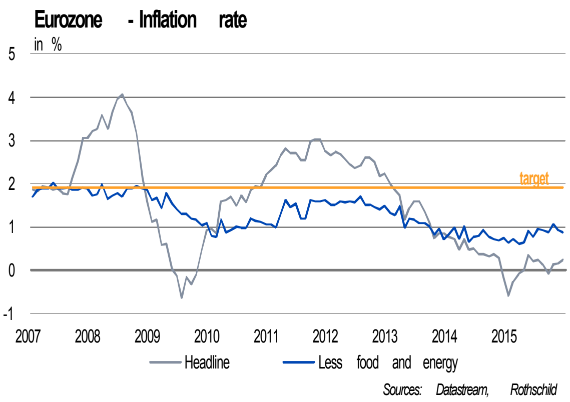
ECB stimulus surprise

ECB - Inflation forecast

	2016	2017	2018
March 2016	0.1	1.3	1.6
December 2015	*1.0*	*1.6*	-
June 2015	*1.5*	*1.8*	-

ECB - Real GDP forecast

	2016	2017	2018
March 2016	1.4	1.7	1.8
December 2015	*1.7*	*1.9*	-
June 2015	*1.9*	*2.0*	-



The economic scenario published by the ECB at its March meeting showed that growth in the euro zone remains moderate, but also that momentum weakened due to the slowdown in emerging markets and the volatility of financial markets. Projections for 2016 even indicate a slight deceleration in growth compared to 2015. As for inflation, the ECB has drastically lowered its forecast for this year, from 1% expected in December to only 0.1%. Moreover, the return to the 2% target is not expected before 2019.

It is against this backdrop that the Governing Council announced the following measures:

- Decrease the refinancing rate to 0% and further reduce the deposit facility rate to -0.4%;
- Increase the asset purchase program by 20 €MM, bringing it to 80 €MM per month until March 2017, or beyond if necessary;
- Expansion of the asset purchase program to include non-bank corporates bonds;
- Establishment of a new long-term funding program – TLTRO2.

Clearly, the TLTRO2 was designed to provide euro area banks with compensation for the costs incurred by the additional decrease in the deposit rate. Indeed, not only will banks be able to borrow from the ECB up to 30% of their loan portfolio at a rate of 0% for a period of 4 years without conditions, but those that have expanded their loan book to the private sector will see this rate reduced to ... -0.4%. In other words, the ECB could reward banks that have fostered the growth of credit. Similarly, the possibility of a negative differential rate system, based on the amount of deposits, was discussed, but was not retained. In doing so, the ECB wanted to signal that it does not intend to lower the deposit rate level indefinitely, also recognizing that the establishment of a differentiated system "à la japonaise" was far too complex for the euro area. It is therefore good news for the banking sector, where some were concerned by the cost of an increasingly negative deposit rate. For its part, the expansion of purchases to non-bank corporates might be able to mitigate the recent credit market pressures. However, the specifics remain to be defined and may be very complex: what sectors, which countries ... In the end, the ECB released the heavy artillery to respond to a highly uncertain macroeconomic environment. Nonetheless, during his press conference, Mario Draghi stressed that the deposit rate likely has reached a bottom, even though the IMF may revise its forecast for global growth downward in the coming weeks. This might explain the mixed sentiment following the announcement.