Over to the ECB

- **Unanimity of view on the need for fresh stimulus?**
- **Revival in inflation expectations rests with Mr Draghi**
- **Raising expectations never the ECB’s weak point**

Tomorrow’s ECB meeting interrupts what has been a protracted period of intent focus upon US monetary policy. The ECB is aware of what is at stake; whether it delivers is another matter.

Outside of certain northern European circles, there is, we suspect, something approaching a unanimity of view on the need for some sort of fresh stimulus from the ECB, preferably as soon as tomorrow.

Export dependence has turned on the eurozone, in part due to Germany’s skewed orientation towards China’s economy. And the end of a particularly long economic cycle encompassing unprecedented stimulus currently finds eurozone core inflation no higher than the lowly levels of five years ago.

If forecasters are prescient then there will be little change to today’s batch of manufacturing PMIs from the sub-50 levels that have prevailed (in aggregate) across the region since February.

And this is unlikely to lift either economic sentiment (already at a three-year low) or investors’ (somewhat more depressed) spirits.
There will be no meaningful fiscal stimulus to lend a hand – something that Angela Merkel made very clear

Indeed, their revival – along with inflationary expectations, which were, until very recently, the lowest on record – is now in the hands of the ECB.

Certainly, there will be no meaningful fiscal stimulus to lend a hand – something that Angela Merkel made very clear just last week.

The phoenix-like revival of the 5-year/5-year inflation break-even rate this past month (it has risen 0.16% points) was down to Mario Draghi’s clear allusions to fresh stimulus in Sintra in June – as was a 65bp slide in 10-year Italian BTP yields.

Unfortunately, as things stand, it is not clear what we should expect tomorrow. Recent comments by a number of Council officials have seemingly chimed with the sense of urgency conveyed at Sintra; but equally, reports have also suggested that policymakers are in “no rush” to cut rates.

Ironically, raising expectations has never been the ECB’s weak point; delivering, on the other hand, has been another matter. And if a weaker EUR is seen as an important outcome of the decision (it is inflation and exports that are flagging, after all, not bank lending), then the December 2015 Council should provide a salutary lesson for Mr Draghi and his successor in 2019.

Mario Draghi has to run the gauntlet of market expectations and criticism from the US

The Bank’s inability to live up to the promises from three months earlier saw the EUR leap a staggering 3% on the day and by a further 7.5% over the next four months.
And these contradictory voices that have often stemmed from Council may help to explain why overnight realized volatility in EUR/USD has spiked north of 20% three times following ECB meetings over the past six years.

It should be noted then that Mario Draghi not only has to run the gauntlet of market expectations he must also face up to likely criticism from the US. When Mr Draghi hinted at plans for fresh stimulus at Sintra, President Trump accused the ECB President of currency manipulation, noting: “They have been getting away with this for years”.

Certainly, CFTC data shows that at 31,351 contracts, non-commercial accounts’ short positions in the euro are far from the extremes of 2015 and 2016; but even at this level, the ingredients for some revival in volatility are hardly lacking.

Please direct questions or comments to:

AerialView@BNYMellon.com

Disclaimer