

ECB's January minutes: Weaker growth prospects call for a review of the monetary policy stance in March

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- ECB's Account of its monetary policy meeting on January 20-21 was largely consistent with the dovish tone ECB President Mario Draghi adopted at the January press conference, suggesting that the monetary policy stance could be reviewed and reconsidered at the March meeting due to increased downside risks to the Euro area. Nevertheless, there was no discussion on preferred policy options for further easing, but only a confirmation that a wide range of instruments and tools could be used.
- ECB Governing Council (GC) members highlighted that downside risks to the Euro area outlook stemming from a weaker global growth environment and volatile financial markets "might at present be materializing". Given the continuing divergence between relatively resilient domestic demand and decelerating external trade, the GC pointed out that it remains to be seen whether robust domestic growth could continue to offset weakness in external demand.
- On the inflation front, concerns were expressed that lower oil prices could dampen wage growth and core inflation through second-round effects. ECB Executive Board member Praet noted that although there was evidence that the December monetary policy easing measures were being transmitted, downside risks to the baseline scenario included in the ECB staff macroeconomic projections were escalating. Indeed, the 5y5y forward inflation swap rate was hovering around 1.434% at the time of writing this report, within distance from a fresh historical low of 1.425% recorded on 12 February, suggesting further deterioration in the inflation outlook amid weaker growth outlook.
- Along these lines, we continue to expect the ECB will likely cut the deposit facility rate by another 10bp to -0.40% at its March 10th monetary policy meeting. In the adverse scenario that global growth deteriorates more than currently anticipated (sharper deceleration in China and other EM economies and/or further decline in commodity and oil prices), inflation expectations move lower or/and the EUR moves sharply higher against its major currency peers, the ECB could potentially adopt a more aggressive monetary policy stance including, inter alia, a larger than 10bps rate cut and/or an expansion/extension of the €60bn monthly QE purchases.

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