

ECB BMCG

A review of central banks' strategies and monetary policy tools

4 March 2020

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1 Overview – What is the review all about

The ECB “will turn each and every stone” (Christine Lagarde)

The ECB's Eight-Pronged Review

Inflation goal	(De)globalization
Measuring Inflation	Digitalization
Policy instruments	Communication
Macroeconomic modeling	Climate Change

Bloomberg 



Not under review:
“Price stability is the primary objective”
 EU Treaty, Art 127 (1)



But: ECB definition
“will be core and centre” to our review”
 (Christine Lagarde, 12 December 2019)

Source: ECB, Commerzbank Research

ECB press release (23 January):

Review to cover

- quantitative formulation of price stability
- monetary policy toolkit (including effectiveness and the potential side effects)
- economic and monetary analyses
- communication practices
- financial stability
- employment
- environmental sustainability

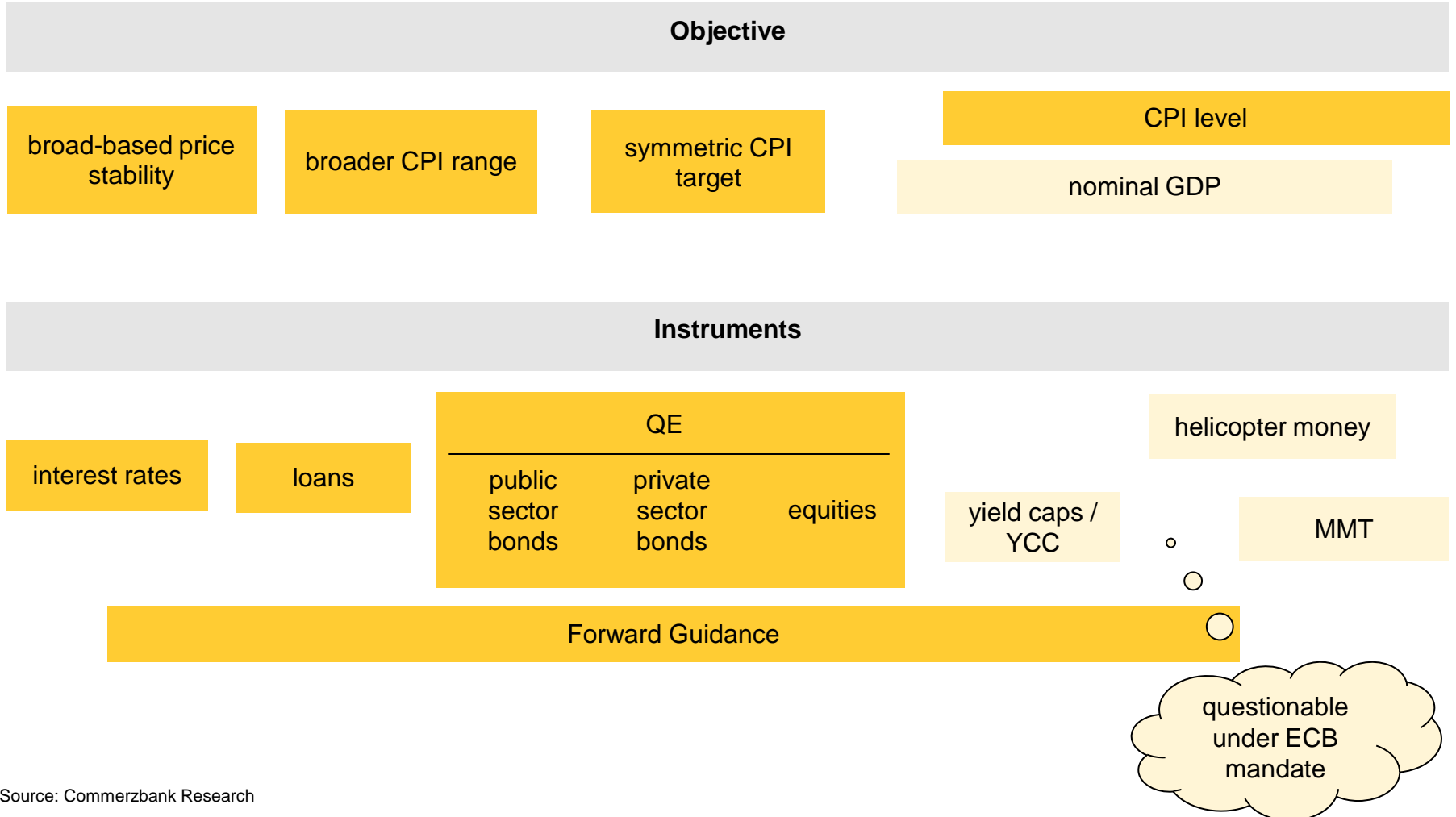
2 principles:

- thorough analysis
- open minds

Review is expected to be concluded

- by end of 2020
- after engaging with all stakeholders

Major central bank objectives and instruments



Source: Commerzbank Research



2 The definition of price stability

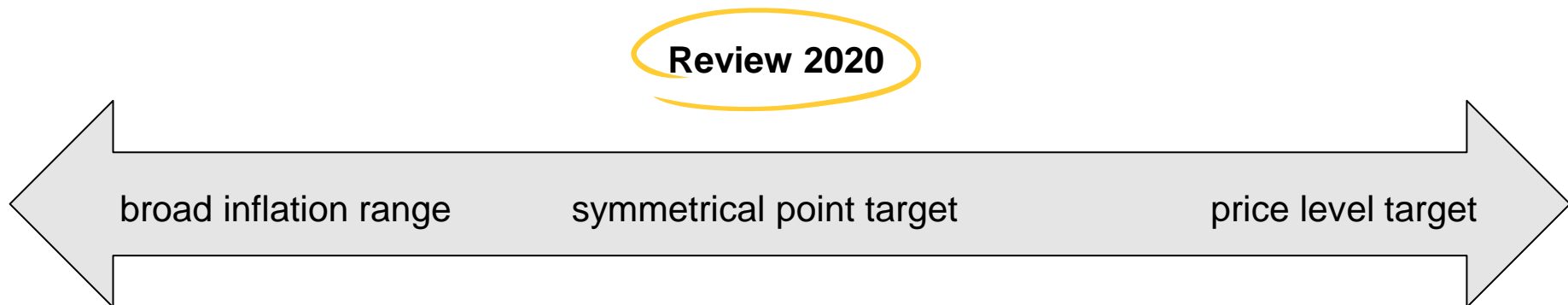
How to define “price stability” – more than just semantics!

Quantitative definition of price stability (1998)

*"Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of **below 2%.**"*

Clarification (2003)

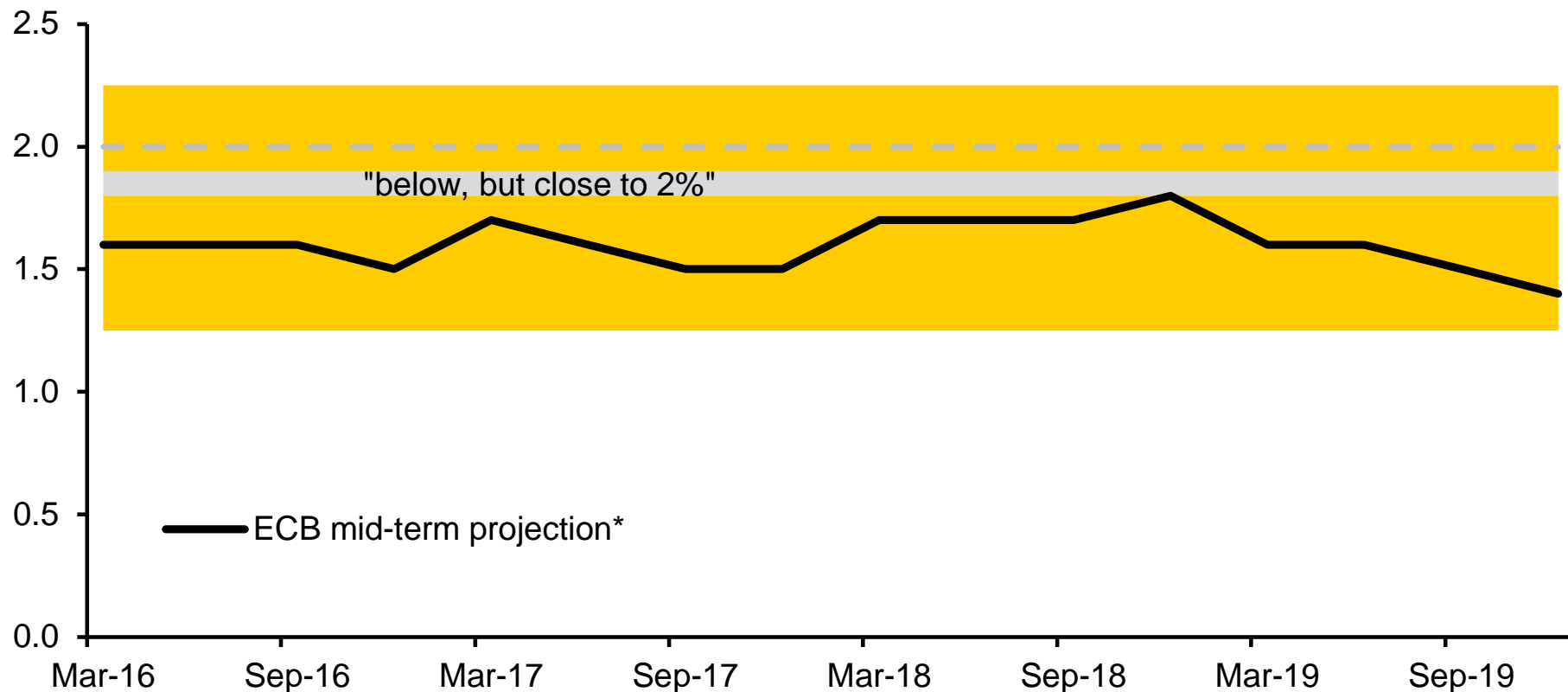
“The Governing Council clarified in 2003 that in the pursuit of price stability it aims to maintain inflation rates **below, but close to, 2%** over the medium term.”



Source: ECB, Commerzbank Research

Implications of symmetric point target vs broad target range

Current ECB definition of price stability (assumed as symmetric 1.8-1.9% target) and inflation tolerance band (Commerzbank proposal 1 ¼ to 2 ¼ target range)

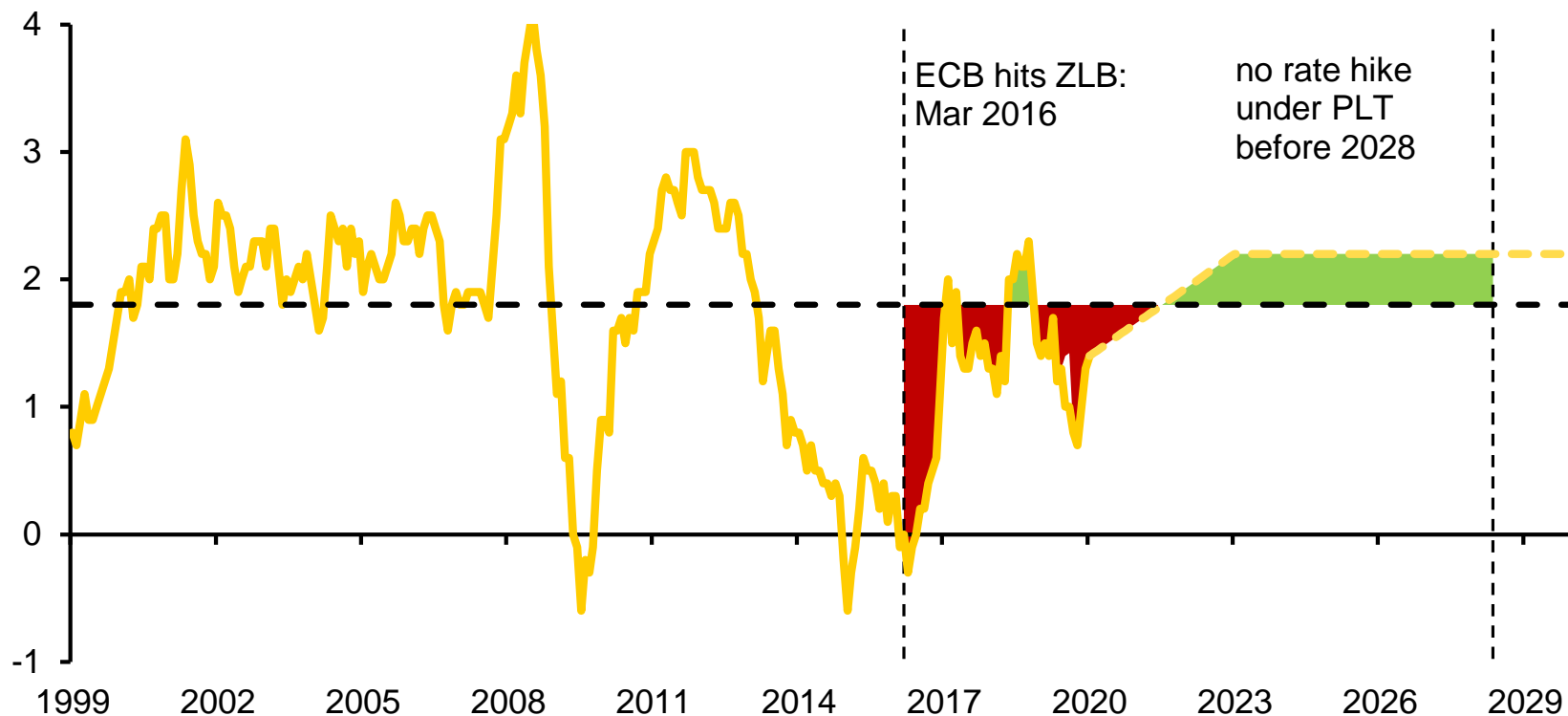


* Projection two years ahead
Source: ECB, Commerzbank Research

“Price Level Target” would be very different from “inflation target”!

“Make-up” strategy under Price Level Target would push first hike far into the future!

Euro area CPI, yoy in %, simulation of ECB rate impact under temporary price level targeting* assuming inflation rises to 2.2% in three years and stays there



* Temporary PLT as proposed by Ben Bernanke, details see *Ahead of the Curve*, 11 April 2019

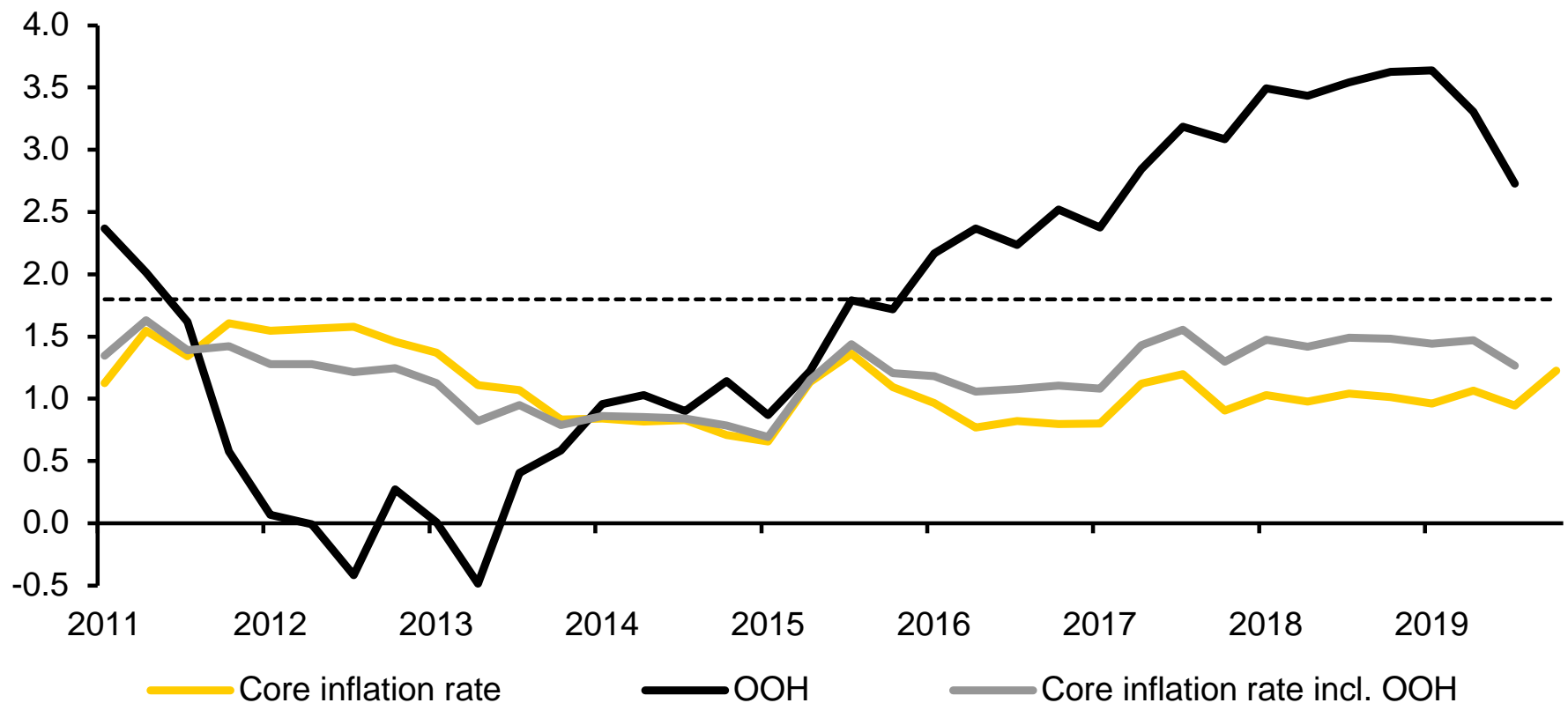
Source: Bloomberg, Commerzbank Research



3 The right inflation measure

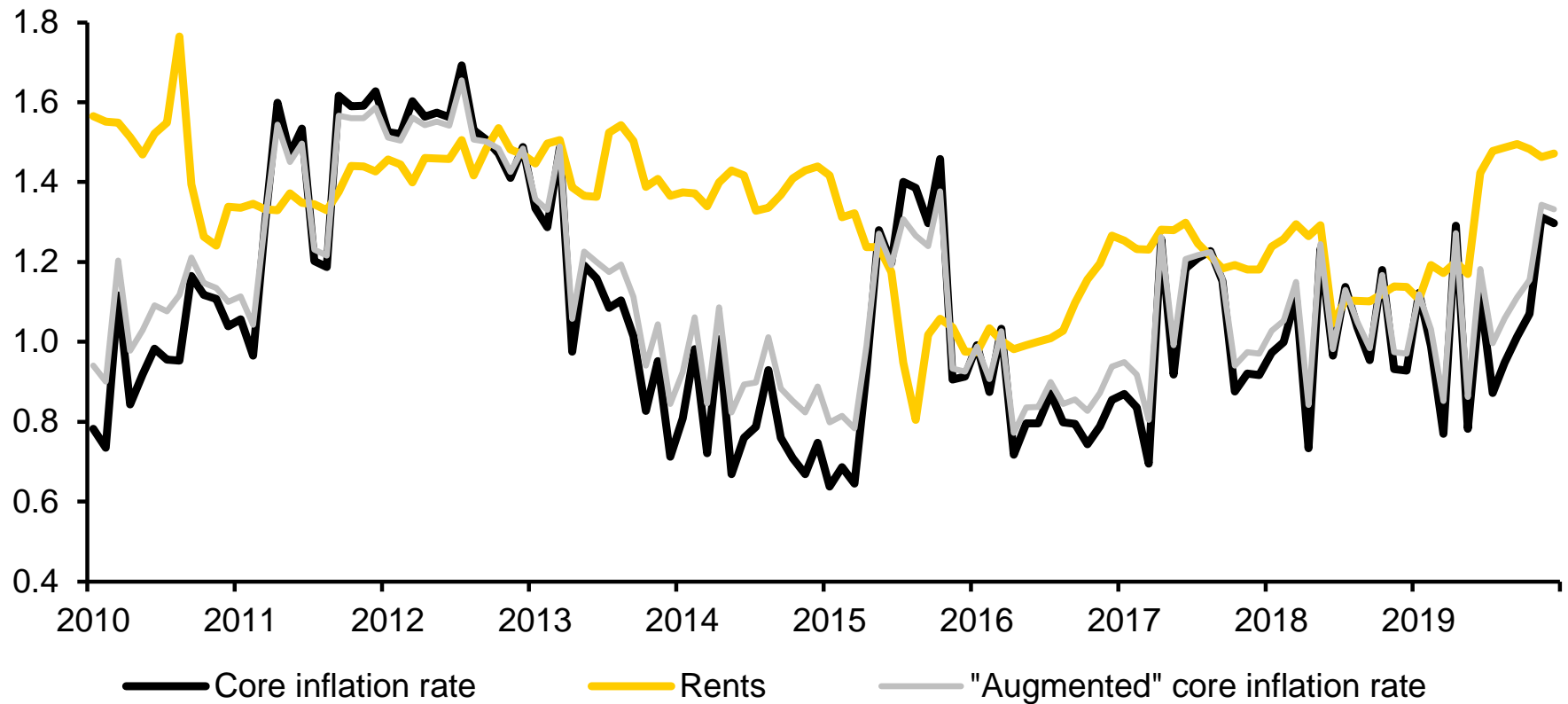
Including OOH: Easier said than done

Quarterly figures, change on year in percent; core inflation rate: HICP w/o energy, food, alcohol and tobacco; OOH: Owner occupied housing price index



A practical workaround: Higher weight for rents – also no game-changer!

Core HICP (excluding energy, food, alcohol and tobacco), rents, and core HICP with weight for rents increased to 20.5% from 6.5% to reflect OOH, yoy in %





5 Discussion points

Discussion points:

- › How could strategy changes from other central banks impact the ECB or market expectations about what the ECB will deliver?
- › What is the market consensus on the outcome?
- › How would different market segments react to the different proposals (real yields, break-evens, curves and spreads)
- › Should all results be published as big bang at year-end or should they be revealed sequentially?

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I) Recommendations versus benchmarks:

Overweight (OW) We expect outperformance versus the benchmark in spread and/or total return terms
Marketweight (MW) We expect performance in line with the benchmark in spread and/or total return terms
Underweight (UW) We expect underperformance versus the benchmark in spread and/or total return terms

Benchmark: Unless stated otherwise, the benchmark is the iBoxx € Corporate for IG-rated names/instruments, and the iBoxx € High Yield core cum crossover LC for HY-rated names/instruments

II) Outright recommendations:

Buy We suggest entering / expanding positions in the relevant names/instruments
Sell We suggest reducing / closing positions in the relevant names/instruments

Time Horizon: Unless stated otherwise, the time horizon for our recommendations is three months.

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	All covered instruments	The proportion of issuers in each of these categories for which Commerzbank provides investment banking services
Overweight	39%	30%
Marketweight	46%	39%
Underweight	15%	28%

Source: Commerzbank Research

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Long/Buy	35%	7%
Neutral	23%	0%
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Source: Commerzbank Research

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