

Economics Group

Special Commentary

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European Central Bank – Watching and Worrying

Executive Summary

The European Central Bank’s (ECB) October 29 monetary policy meeting takes place against a worsening economic backdrop. We do not expect a policy change at that meeting, though the ECB will likely offer a more cautious economic assessment. The chance of further easing may be rising; however, it is not yet our base case. If the Eurozone recovery fails to gain sustainable traction, the central bank may feel compelled to ease further during the first half of 2021.

The chance of further ECB easing may be rising.

European Central Bank to Stay on Hold, for Now

The European Central Bank’s (ECB) October 29 monetary policy meeting takes place against a more uncertain Eurozone economic backdrop. Eurozone activity staged a solid recovery over the summer, and while the consensus estimate is Q3 GDP grew 9% quarter-over-quarter, there might even be upside risk to that forecast. Of more concern is the outlook for the Eurozone economy in Q4 and beyond. There has been a resurgence in the spread of COVID across the continent, and over the past week, the average daily increase in new cases is nearly 80,000/day. In response, some Eurozone governments have re-instituted restrictions, albeit not as stringent as during the European spring, a factor that could slow the momentum of the recovery. Accordingly, in our view, the risk is for much slower—or even a pause—in Eurozone Q4 GDP growth. Of note, the October services PMI is forecast to fall to 47.0, which would be a second straight month back below the breakeven 50 level.

Figure 1

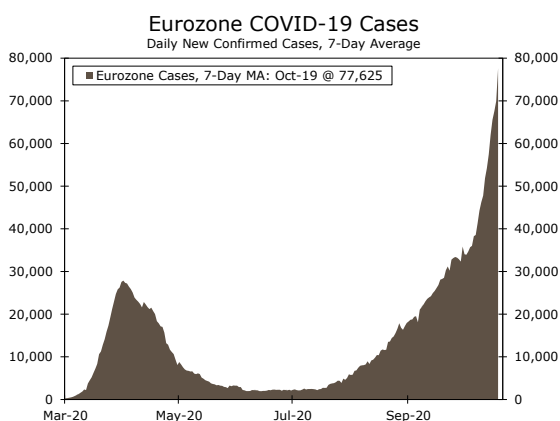
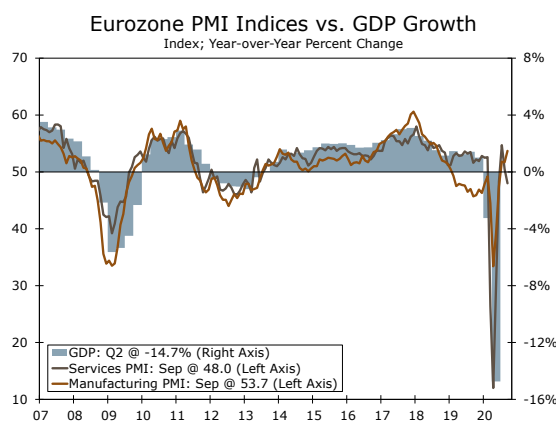


Figure 2



Source: Bloomberg LP, Datastream and Wells Fargo Securities

Clearly these recent developments are a challenge to our base case that previous Eurozone monetary and fiscal policy stimulus would support a steady economic recovery, and keep ECB monetary policy on hold through the rest of this year, as well as in 2021. We do not expect the central bank to ease monetary policy at its October announcement, either through lower interest rates or increased asset purchases. However, the ECB could well offer a more cautious economic assessment and repeat that it stands ready to adjust its monetary policy instruments as needed, without necessarily signaling that any such adjustment is imminent. The central bank has plenty of

scope for further asset purchases within its current program. For example, cumulative purchases under the Pandemic Emergency Purchase Program are currently €601B, out of a total program size of €1,350B.

It is not clear how much the Eurozone economy would benefit from lower interest rates or further asset purchases, and as the ECB has made clear, it would surely prefer to see further government fiscal stimulus as a complement to its monetary policy actions. At the same time, if the Eurozone recovery fails to gain sustainable traction or confidence deteriorates, the ECB may eventually feel compelled to act during the first half of next year. In addition, compared to past cycles, the ECB has acted sooner rather than later during the current cycle. Thus, while the case for further monetary policy easing is building, it is not yet our base case. Meanwhile, we will closely watch the ECB announcement, as well as Eurozone GDP, CPI and confidence data later this month, for further insights into the path of the Eurozone economy and policy.

The ECB has made clear it would prefer to see further government fiscal stimulus.

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