ECB BMCG
A review of central banks’ strategies and monetary policy tools
4 March 2020

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Agenda

1. Overview: What is the review all about

2. Focus 1: The quantitative definition of price stability

3. Focus 2: Measuring inflation

4. Discussion
1 Overview – What is the review all about
The ECB “will turn each and every stone” (Christine Lagarde)

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

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
### Major central bank objectives and instruments

**Objective**

<table>
<thead>
<tr>
<th>Objective</th>
<th>CPI level</th>
<th>nominal GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>broad-based price stability</td>
<td></td>
<td></td>
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<tr>
<td>broader CPI range</td>
<td></td>
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<tr>
<td>symmetric CPI target</td>
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</tbody>
</table>

**Instruments**

<table>
<thead>
<tr>
<th>Instruments</th>
<th>QE</th>
<th>Forward Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>interest rates</td>
<td>public sector bonds</td>
<td>helicopter money</td>
</tr>
<tr>
<td>loans</td>
<td>private sector bonds</td>
<td>yield caps / YCC</td>
</tr>
<tr>
<td></td>
<td>equities</td>
<td>MMT</td>
</tr>
</tbody>
</table>

Source: Commerzbank Research

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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.”

Review 2020

broad inflation range  symmetrical point target  price level target

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 %

The right inflation measure
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

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Buy We suggest entering / expanding positions in the relevant names/instruments
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<table>
<thead>
<tr>
<th>All covered instruments</th>
<th>The proportion of issuers in each of these categories for which Commerzbank provides investment banking services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overweight</td>
<td>39%</td>
</tr>
<tr>
<td>Marketweight</td>
<td>46%</td>
</tr>
<tr>
<td>Underweight</td>
<td>15%</td>
</tr>
</tbody>
</table>

**Source:** Commerzbank Research

### Distribution of Commerzbank AG rates research recommendations as of 31 March 2019

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</tr>
</thead>
<tbody>
<tr>
<td>Long/Buy</td>
<td>35%</td>
</tr>
<tr>
<td>Neutral</td>
<td>23%</td>
</tr>
<tr>
<td>Short/Sell</td>
<td>42%</td>
</tr>
</tbody>
</table>

**Source:** Commerzbank Research

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