ECB keeps door open to easing after holding rates steady

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July 21, 2016 – *The Globe and Mail / Reuters*

The European Central Bank kept interest rates unchanged on Thursday but left the door open to more policy stimulus, highlighting “great” uncertainty and abundant risks to the economic outlook.

Signalling a readiness to act, ECB President Mario Draghi argued that Britain’s decision to leave the European Union and weak emerging market growth both dampen the euro zone’s own outlook, leaving the balance of risks tilted firmly to the downside and possibly requiring action.

But Draghi also noted that growth and inflation were both moving along the path projected in June so more evidence, including fresh staff projections in September, were needed before any decision.

“If warranted to achieve its objective, the Governing Council will act by using all the instruments available within its mandate,” Draghi said. “So I would stress readiness, willingness, ability to do so.”

The balanced comments give the ECB time until its September meeting to weigh the economic costs of Brexit without fuelling excessive market expectations, potentially leading to disappointment, even if it does decide to act.

Indeed, the euro and German yields were broadly unchanged late on Thursday with little volatility during Draghi’s news conference.

“All in all, today’s meeting was one that will quickly disappear from memories,” ING economist Carsten Brzeski said. “More action in September is possible but not yet a given.”

Keeping its deposit rate at minus 0.4 per cent and the main refinancing rate at 0.00 per cent, the bank reaffirmed its guidance to keep rates at current or lower levels for an extended period and beyond the scope of its asset purchase program.

It also repeated that its 80 billion euro ($88-billion) per month asset-buying programme – which Draghi deemed “quite successful” – would run until March 2017, or beyond if necessary, until it sees an upward adjustment of inflation toward its target.

Overall, the ECB is buying €1.74-trillion ($1.91-trillion) worth of assets to cut borrowing costs, induce spending, lift growth and ultimately raise inflation, which has been stuck either side of zero for the past two years.

But such generosity in monetary policy is bumping up against limits. Draghi has consistently called on euro zone governments to loosen their spending to help out, tweaking his standard statement to argue that government reforms need to be “substantially stepped up”.

One of imminent issues to handle is the risk that the ECB is running out of qualified assets to buy, particularly German government debt, as yields have fallen below its deposit rate, a self-imposed limit for its buys.

Draghi declined to address the issue, disappointing some expectations, but said that technicalities would not stand in the way of the asset buys and the ECB would review the programme if necessary.

Brexit and Italy

Brexit has been seen as a threat to the euro zone’s modest investment and consumption-led recovery. But on Thursday, Draghi appeared calm about it.

“Our assessment is that euro area financial markets have weathered the spike in uncertainty and volatility with encouraging resilience, he said.

“The announced readiness of central banks to provide liquidity if needed, and our accommodative monetary policy measures, as well as our robust regulatory and supervisory framework, have all helped to keep market stress contained.”

The threat remains, however. Early post-Brexit data, such as Germany’s ZEW sentiment indicator and euro zone consumer confidence figures, suggest a significant drop in confidence.

But while analysts polled by Reuters cut their 2017 euro zone growth forecasts to 1.3 per cent from 1.6 per cent, they left their inflation projection unchanged at 1.3 per cent, a mixed reading for the ECB, which targets inflation at just below 2 per cent.

Italian banks, weighed down by about a €360-billion ($400-billion) in bad debt and falling share prices, are also a headache for the ECB, which is the euro zone’s bank supervisor.

The Italian government is in talks with the EU to allow state aid to the troubled lenders but wants to shield household investors, a contentious proposal that would test the bloc’s new bail-in rules.

Draghi repeated the bank’s position that something needed to be done to address the problem of bad loans and also called public backstop in such case “useful” but said this was ultimately between Italy and the European Commission to work out.