ECB, keeping rates unchanged, stays quiet about future policy

By Francesco Canepa and Balazs Koranyi
October 20, 2016 – *The Globe and Mail / Reuters*

The European Central Bank kept interest rates on hold at historic lows on Thursday and its president said the Bank was committed to pursuing substantial asset purchases aimed at spurring growth and inflation.

But in a news conference, Mario Draghi gave few hints as to what measures the Bank could take later this year to ensure the asset-buying continued smoothly, saying only that policy-makers "took stock" of technical work on options being conducted by their staff.

He added that the policy makers did not discuss either ending the program or extending it.

"Sometimes it's ... important to say what we did not discuss. And we didn't discuss tapering or the intended horizon of our asset purchase program," he said.

With the eurozone economy enjoying what Draghi called "a moderate but steady" recovery, he defended the stimulus effort as being more successful than the ECB had hoped, and rejected suggestions that ultra-low rates were counter-productive.

"The conclusion was they don't hinder the transmission of our monetary policy. In other words, low rates work," he said.

In a widely expected decision earlier, the ECB kept the deposit rate at minus 0.4 per cent and maintained its guidance for rates to stay at their current or lower levels for an extended period.

The euro initially rose 0.5 per cent to $1.1040, after hitting a three-month low of $1.0952 earlier in the day. However it later fell back to $1.0938.

The ECB has provided unprecedented stimulus for years with sub-zero rates, free loans to banks and over a trillion euros in bond purchases, all in the hope of reviving growth and lifting inflation back to its target of just below 2 per cent after more than three years of misses.

The so-called quantitative easing (QE) scheme is now set to expire in March but the bank has always said that it would run until it saw a sustained recovery in inflation.

Any meaningful extension of asset buys will however require the ECB to modify some of the program's technical constraints to counter the scarcity of some assets, like German bonds.

Those changes could include relaxing some of the ECB's self-imposed constraints, like the rule prohibiting the bank to buy assets yielding less than its deposit rate or the rule requiring it to buy assets in proportion to each country's shareholding in the ECB.

"We remain committed to preserving the very substantial degree of monetary accommodation which is necessary to secure a sustained convergence of inflation towards levels below but close to 2 per cent over the medium term."

"Right now, we have options," he said of the status of considerations before a December meeting where decisions are widely expected.

Chugging along

The euro zone economy is chugging along, inflation is at a two-year high, national budget proposals suggest a bit more fiscal support, and the early impact on euro zone economies of Britain's decision to leave the European Union has been muted.

Draghi said third-quarter growth in the eurozone was expected at around the same 0.3 per cent achieved in the second quarter while noting that risks to that outlook remained tilted to the downside, largely due to external factors.

Analysts polled by Reuters unanimously expect unchanged rates with the vast majority predicting a three to six month extension to asset buys in December.

For the ECB, the root of the problem is that inflation is still too weak and may not hit the target for another 2-3 years at the earliest.

Though it rose to 0.4 per cent last month and may exceed 1 per cent by the spring, the rise is due almost entirely to the fading impact of a drop in oil prices and not a rebound in underlying prices.

Wage growth meanwhile remains weak, core inflation is stuck below 1 per cent and unemployment is high, suggesting that the rise is far from the sustained increase the ECB had hoped for.

Lending growth is also showings signs of leveling off, suggesting that banks may be struggling to pass on some of the ECB’s ultra loose policy measures.

Draghi reaffirmed repeated calls to euro zone governments to support ECB policy with pro-growth fiscal measures and structural reforms, adding the focus should be on actions to raise productivity and improve the business environment.