April 21, 2016

TD Economics

International Commentary: The ECB leaves monetary policy unchanged, releases further details on its plan to purchase corporate assets

- The ECB's Governing Council held its interest rates on main refinancing operations (0%), marginal lending (0.25%) and deposit facilities (-0.4%) unchanged this morning. Monthly asset purchases will continue at €80 billion as communicated at the previous March meeting.

- More importantly, details for the ECB's corporate sector purchase program (CSPP), set to begin this June, were announced. Broadly speaking, these asset purchases will include euro denominated debt instruments issued by Eurozone domiciled non-credit institutions. Debt instruments with a maturity of between 6 months to 30 years and with minimum credit rating of BBB- will be purchased, but in most cases limited to 70% of total issuance of any qualifying debt series.

- During the press conference, ECB President Mario Draghi addressed concerns about the impact of negative interest rates, the ECB's willingness to ease further, and pushed back against political interference by member nations concerning its low interest rate policy. On negative interest rates, he stated that negative deposit rates seem to have been positively received, citing that depositors thus far have been successfully shielded from negative deposit rates. Furthermore, bank surveys suggest that recent actions by the ECB are encouraging loan growth, although so far it seems to be having a larger effect on price and loan terms rather than volumes. When pressed on the ECB's desire to ease further, he responded that the governing council is ready to act if events pushed the economic recovery away from the medium term outlook. Lastly, criticism about the legality of the ECB's operations were addressed by confirming that the ECB has been acting well within the established legal framework in order to achieve its mandate of price stability. Furthermore, President Draghi made it clear that any political interference by member nations acts to threaten the ECB's independence, saying that historically, reducing a central bank's independence has delayed achieving economic objectives, and that delaying the process may require even more stimulus.

Key Implications

- The ECB is confident that additional stimulus measures announced this past March are gradually helping to strengthen the credit system, spurring loan creation, and supporting economic growth sufficient to accelerate inflation and ensure that it hits target in the medium term. Having said that, the ECB highlighted the need for a combination of policies to encourage growth, most notably that highly accommodative monetary policy must be accompanied by structural reforms, and growth friendly fiscal expenditures – namely a combination of lower current public expenditures, lower taxes, and more public investment.

- Growth in the Eurozone has generally been disappointing for a number of years, but is showing some signs of improving momentum in the first half of 2016. Rising retail sales and new passenger vehicle registrations in the first quarter offer more concrete evidence of a firming of growth than do the more disappointing surveys of consumer and business confidence. So far it appears that growth is on pace to meet our March forecast of 1.4% this year, strengthening further to 1.7% as the impact of these recently announced stimulus measures take hold and begin to spur economic activity. However, the biggest risk to our outlook for the EU is the UK referendum on EU membership set for June 23rd. While our baseline forecast assumes that the UK remains a part of the EU, a vote to leave would likely have some very severe consequences for both the UK and the Eurozone.

- Although there are signs that growth is firming up, inflation pressures continue to remain subdued, with the flash estimate of headline March Eurozone inflation at -0.1% y/y, marginally better than the February inflation print of -0.2% y/y. Despite rising commodity prices (oil in particular), the high degree of underlying slack evident in many Eurozone economies is likely responsible for holding down price pressures. What's worrying is the high correlation between oil prices and survey measures of Eurozone inflation expectations in recent months, which signals a risk of inflation expectations becoming unanchored. But, as noted by the ECB today, this correlation has weakened since additional monetary easing was announced last month, and inflation will likely remain below the ECB's 2% target through the medium-term, consistent with our March QEF forecast.

Fotios Raptis, Senior Economist
416-982-2556

@TD_Economics