

July 27, 2012

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# Eurozone: ECB Puts Itself Back in the Spotlight

## ECB Puts Itself Back in the Spotlight

Recent comments from the ECB hierarchy, but particularly a speech from President Draghi, have put the central bank very much in the market spotlight. Last Thursday, President Draghi stressed that the ECB would do whatever it needs to preserve the euro, underscoring that it definitely do enough. Perhaps most notably, he also underlined that the ECB can act from within its existing mandate should sovereign premia be seen as hampering the monetary policy transmission mechanism.

## Resumed Bond-Buying?

This was widely seen as a sign that *the ECB is reacting to the fresh bout of peripheral market turmoil by hinting that it will resume the government bond-buying program* that was revived last summer but has been in abeyance earlier this year. After all, it was problems with the monetary policy transmission mechanism that was used for the creation of the Securities Markets Program in the first place back in May 2010. As a result, markets will be looking for hints or more explicit signs from the ECB meeting on Thursday that the central bank is willing to back up its rhetoric with the promise of action. Admittedly, *other courses of action could be on the cards, including the introduction of a negative deposit rate as well the possible agreeing to the ESM getting a banking license*, the latter being something that Austrian ECB member Nowotny pointed to in keynote comments this week.

## Overcoming German Resistance

*The problem is that the Bundesbank has made clear its resistance to such measures, believing them to be clouding the difference between monetary and fiscal policies as well as diminishing the pressure on government to reform.* However, it seems unlikely that the ECB is offering 'smoke without fire'. Instead, some compromise that will probably use the (limited) resources of the EFSF may be on the table, accelerating something that was hinted at the EU Summit last month.

## Deflation Risks Recognized

Very clearly the latest bout of peripheral market turmoil has made the ECB wake up to the risks the Eurozone faces. Indeed, given the restraints posed by the German decision to postpone ratification of the ESM until at least September, the ECB realizes that markets need clear short-term support. However, as the ECB is keen to underline, it very much wishes to be seen to be acting within its mandate. In this regard, it is therefore very notable that the ECB has started to point to a softer inflation backdrop, even embracing (perhaps somewhat belatedly) deflation risks. *The fact that such a deflation risk would be inconsistent with the price stability remit of the ECB may be a means by which the Council could temper, or even ignore, any German resistance to fresh unconventional stimulus measures.*

**DE View:** The ECB Council meeting next Thursday is unlikely to see a further cut in the repo rate, such a cut instead being left until the September meeting when a clearly softer inflation picture will be unveiled in the updated economic projections due at that juncture. Even so, President Draghi next week may be more open about a softer inflation outlook, this conveniently giving the ECB both scope and rationale to resume the likes of bond purchases that it has been hinting at.