Central Banks / Global Economy

Looser monetary policy

El País (Spain)

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Some kind of policy reaction to the weak tone of Europe's economy was expected at the ECB meeting last week, in view of the delay in signs of recovery, particularly after the more downbeat tone adopted by members of the ECB Board. Draghi caused surprise by passing measures that were clearly on analysts 'and markets' radars, but which have been brought forward earlier than scheduled.

The ECB gave three clear signs of relaxation. Firstly, it indicated that there will be a delay in the hikes to benchmark interest rates, which will remain unchanged until at least December (instead of September) 2019. This is not a huge surprise and, in fact, it is more than likely that at some point he will delay these rises again until mid-2020. Secondly, he approved a new round of liquidity provisioning for banking institutions, to progressively replace the 2016 provisions (known as TLTROs), thus smoothing a transition for financial institutions' heavy maturities in the next few years. In the absence of specific details, the cost of this financing is unlikely to be as favourable as the previous round, but the amounts for which entities can apply are generous.

Thirdly and lastly, the ECB has significantly cut its growth forecasts, especially those for 2019, reducing its GDP growth estimate to 1.1%, compared to its prediction three months ago of 1.7%. The ECB continues to forecast a recovery in 2020 (1.6%), and Draghi indicated that the weakness is more external (through exports) than domestic. But the fact that the ECB is still referring to risks to the downside (in spite of this correction) seems to indicate that it is not entirely sure. Inflation estimates have been sliced too, the upshot being that all these signals, taken together, have sent a message of weakness about the European environment, which has probably influenced the markets' bad reaction to measures that, lest we forget, are accommodative.

Against this backdrop, two issues should be kept under scrutiny over the next few months. First, the technical details of the new liquidity provision, which will condition how this financing route will be used by the banks. And second, and more importantly, how the eurozone economy performs, that is, whether the weakness reverses, as the ECB expects, or not. If the temporary factors that have led to the slowdown − problems in certain sectors, uncertainty about protectionism and Brexit, lower demand from Asia − persist, in the second half of the year we could find ourselves facing an outlook that is quite a bit worse than forecast.

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