Central Banks / Global Economy

Mario Draghi: Monetary Policy Is Not Sufficient

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At its meeting last Thursday, the European Central Bank (ECB) launched a comprehensive package of easing measures, as Draghi had—for all intents and purposes—been signaling over recent months (in his speech at Sintra and, most significantly, at July's monetary policy meeting). Some of the institution's members had recently questioned the need to expand the asset purchase program (APP), and it was unclear as to whether or not they would be included in the package. Similarly, many analysts had disputed the relevance of such purchases; in a recent survey, an overwhelming majority expected a decision similar to the one made last week, but almost the same percentage believed that it would not be an effective one. In any case, the more accommodating line of action adopted by Draghi has once again prevailed.

The doubts that remain around the effectiveness of monetary policy were also evident in a key feature of Draghi's appearance last Thursday –his repeated references during the Q&A session that fiscal policy should be at the forefront of the revitalization of counter-cyclical policy. The signals that the ECB had given in its statements in this regard had, until now, been subtle, but last week it adopted a more aggressive tone on the matter. The Central Bank has thus joined the chorus of international institutions and analysts arguing that countries that have space for it (i.e. Germany, in particular) should introduce more expansive fiscal policy.

Going to the details, some of the measures announced by the ECB were widely expected by markets and analysts, and others less so. The deposit facility rate was lowered by 0.10% to -0.50%. A somewhat larger cut could have been expected, but the ECB is leaving the door open for that to occur in the future. To mitigate the impact of a more negative deposit rate on the European banking system, a tiered system for deposit facility is being put in place to mitigate the negative rates for banks without limiting their impact on the monetary markets.

Uncertainty around the asset purchase program had increased following recent statements by François Villeroy de Galhau, among others, and the approved program is in the lower range of expectations (EUR 20 billion per month). The purchases are, however, with no time limit, which was not the case for the previous quantitative expansion program; instead, they will continue until there is robust evidence that inflation is moving consistently toward target. They also say that this convergence has to be reflected in terms of core inflation. Draghi also mentioned that the end of QE will be shortly before the next rate increase. All this reinforces the ECB's accommodative forward guidance. In addition, the Central Bank has relaxed the conditions of the new targeted longer-term refinancing operations program (TLTRO-III), with somewhat lower costs, longer maturities (three years rather than two) and repayment permitted during the third year. The purpose of all of this is to increase participation in the program.

Finally, the ECB's quarterly forecasts have been revised downward, with GDP growth being slightly lower and inflation being quite a bit lower. Draghi noted that the likelihood of a recession in the eurozone has increased, but remains low. This is interesting because many consider the ECB's bazooka to be somewhat overblown, given that the growth expected is in line with the potential rate, that the risk of deflation is no longer being discussed and that the headwinds of the European economy reflect the global trend toward protectionism rather than domestic problems.

The impression, then, is that rather than believing his concrete measures to be inevitable, Draghi wants to leave his tenure at the ECB with the message that he has already done everything within his power, and that any further action that may be needed will be up to other institutions and other types of policy.

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