

Opinion | 13 June 2019

ECB: About bazookas and water pistols

At last week's meeting in Vilnius, ECB president Mario Draghi sent a strong signal that the ECB was only one small economic slip away from new stimulus. But what could the ECB still do?



Source: Shutterstock

It was not so much the announced actions – new forward guidance and TLTRO pricing – which surprised financial markets last week but Draghi's comments during the Q&A session, stressing the ECB's readiness to act "if adverse contingencies were to materialise" (see our review of the ECB meeting [here](#)). The surprise moment was when Draghi actually reported that the ECB had discussed options such as rate cuts and restarting quantitative easing in such a scenario. According to Draghi, no one should have doubts about the ECB's policy space.

What could the ECB still do?

Since last week, many market participants are scratching their heads, wondering what the ECB actually still could do if it felt the need to act. Here are some thoughts:

- **Another cut of the deposit rate – the safe bet.** As long as the ECB believes that negative interest rates actually stimulate the economy and do not have significant negative effects (as suggested by a recent [ECB working paper](#) bank profitability is not affected by negative deposit rates) another rate cut looks like the easiest first option. Even without a tiering system. Combined with a tiering system, the ECB would shift away from the bank

lending channel towards the fx channel, possibly bringing the Eurozone back on the US radar screen as a potential currency manipulator.

- **Restart QE – possible but only with some tweaks.** Another relatively easy-to-do option for the ECB. However, a valid question is how much “headroom”, as Draghi put it, the ECB really has to purchase bonds. According to [ECB estimates](#), the current reinvestments still absorb close to 30% of the planned new issuances in Germany in 2019 and 2020 but less than 15% in France, Spain and Italy. Don't forget that the 33% issuer limit was one of the main arguments used by the European Court of Justice in its ruling that QE was not monetary financing. As a result, headroom to significantly restart the sovereign bond purchases is rather limited, unless the ECB would be willing to deviate from the capital key. Instead, the ECB could either increase the issuer limit for EU supnationals (from currently 50% up to 100%) or step up its corporate bonds purchasing programme.
- **Buying stocks – the bold option.** So far only a theoretical or rather hypothetical option but if the ECB really wanted to make a difference, buying equity – or going Japanese – would be the ultimate answer. Obviously, with many strings attached but just think of purchasing stocks, funds or baskets aimed at supporting investments into green technologies or linked to “green” ratings.

Bazooka or water pistols?

All in all, while further rate cuts and restarting QE look like the most likely policy options for the ECB in case it really feels the need to act, none of these options is a magic bullet. In fact, technical, legal or economic limitations to these two types of policy instruments bring back previous euro-crisis memories of wanna-be bazookas, which actually are rather water pistols.

Eventually, the entire discussion of whether monetary policy still can kick-start a stagnating economy in a zero-rate environment will get more attention. If bazookas turn out to be water pistols, the only resort left is fiscal policy. Probably, the only thing that could really work to fight a recession or a protracted stagnation would be fiscal stimulus backed by monetary policy. However, this would require either a Eurozone budget or loosening the fiscal rules. None looks likely in the short run.

Over the last few years, the ECB under Mario Draghi has frequently proven that no one should ever underestimate its willingness to act or simply do “whatever it takes”. At least as long as Mario Draghi is in office, there is nothing worse for the ECB than admitting it has run out of ammunition. The ECB will do everything it can to avoid such a confession. Secretly, most ECB officials will keep their fingers crossed that the ECB's determination to act will not be tested and that the Eurozone economy can avoid new slippages. If not, the next months will quickly show whether Draghi can once again overachieve or whether he has lost his magic touch.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.