ECB: Lagarde's 'whatever it takes'

Last night the ECB announced an all-in programme, in an attempt to redefine its role as lender of last resort.

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What a week for the ECB. Remember that only last week ECB president Christine Lagarde said that she had no intention of having her own 'whatever it takes' moment. Her comment that it was not the ECB's role to keep yield spreads narrow added to the ongoing market turmoil. What followed was an attempt by the ECB to control the damage - with unprecedented tweaks of the transcripts of the Q&A session, chief economist Philip Lane releasing a blog entry explaining the ECB's decisions and several other members of the ECB Governing Council coming out with public statements. This was not enough - at the start of this week Austrian central bank governor Robert Holzmann said that the ECB had basically reached the limits of what monetary policy could achieve and that it was impossible for the ECB to meet market expectations. In his view, the crisis could even have a cleansing effect for the economy. These comments were rebuffed by the ECB, releasing an official statement on its website that it stood ready to adjust all tools if needed. Finally, the Banca d'Italia yesterday reportedly stepped up bond purchases, trying to lower Italian bond yields. Against a background of the ECB wanting to speak with one voice, the seven days had been a disaster.

We don't know whether someone from the EuroTower made a phone cal to Mario Draghi but the beating around the bush should be over, at least for now. Last night, the ECB announced a EUR750bn asset purchasing programme, running at least until the end of the year. It is called the Pandemic Emergency Purchase Programme (PEPP), aka Lagarde's 'whatever it takes'. With this QE programme, the ECB wants to "counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the outbreak and escalating diffusion of the coronavirus". The programme includes all assets eligible under the existing QE programme plus non-financial commercial paper. Also, the ECB announced an easing of its collateral rules, basically including SME loans, in the main refinancing operations.

There are important details, showing the ECB's determination to make this programme work:

- Government bond purchases under the new QE programme will be conducted in a 'flexible manner', allowing for fluctuations in the distribution of purchases across asset classes and jurisdictions.
- The ECB will also buy Greek government debt.
- The programme is de facto open-ended as it will last until the ECB 'judges that the coronavirus Covid-19 crisis phase is over'. It will at least last until the end of the year.

And the final important sentence comes at the end of the statement: "To the extent that some self-imposed limits might hamper action that the ECB is required to take in order to fulfil its mandate, the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks that we face. The ECB will not tolerate any risks to the smooth transmission of its monetary policy in all jurisdictions of the euro area."

The Eurozone's policy reaction is finally roling

All of this means that the capital key will remain the benchmark for all ECB purchases. Issuers' limits will be the first to go, even if this could potentially mean trouble with the European Court of Justice or at least invite some Germans to approach the Constitutional Court again. The ECB's own limits to QE programmes have become reference values.

In the short run, financial markets and the economy will still depend on how the pandemic and with it the preventive government measures to tackle it evolve. This will be the main determinant for the depth of the recession. The fact that the Eurozone has finally come to terms with the magnitude of the crisis should cushion the downswing and is an important prerequisite for a swift rebound. As so often in the past, it took the Eurozone (and this time around also the ECB) a while to react. The policy reactions did not come with one big coordinated swoop, but the package of government stimulus, liquidity and guarantees combined with Lagarde's 'whatever it takes' as it stands right now is strong.

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