

TRENDMACRO LIVE!

On the January ECB Policy Decision

Thursday, January 10, 2013

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No change, as Draghi points to "positive contagion" in the euro area.

Both the [European Central Bank](#) (ECB) and the [Bank of England](#) (BoE) kept their monetary policy stances unchanged at their respective January meetings.

In his [post-decision press conference](#), ECB president Mario Draghi pointed to recent euro area GDP weakness and said that it would continue into 2013, but more recent indicators have broadly stabilized -- albeit at low levels -- and there has been a significant improvement in financial market confidence. This improvement in financial market conditions -- especially for peripheral euro area states -- can easily be seen in today's [Spanish auction](#) results and [Ireland's successful](#) auction this week, in the further tightening of the Spain/France 10-year spread, and in the move to new highs for the year for the STOXX 50 EA bank index (please see charts below and on next page). This continues the recovery in peripheral debt that we have been talking about for some time (see, among many, ["Greece, Done At Last?"](#) November 27, 2012).

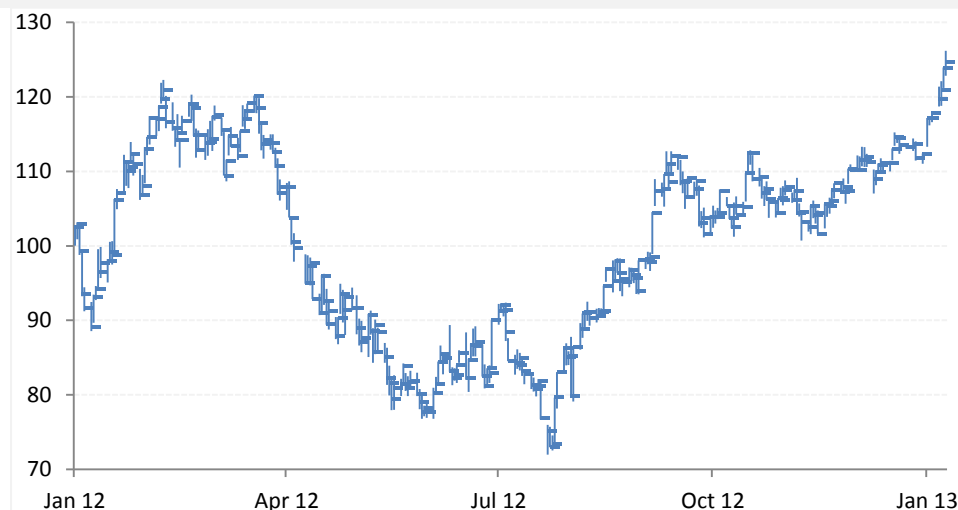
Draghi, in the Q&A at the press conference, seemed content with the current monetary stance of the ECB.

Update to strategic view

ECB, BOE: The ECB and the BoE stand pat on monetary policy. The ECB's Mario Draghi was much more upbeat at this conference than he was a month ago -- considering how much financial markets have improved, it was warranted. We are reducing the chances of a rate cut next month from the ECB to close to zero. Absent a major downside surprise in the coming months, the next rate move from the ECB will be up, but that should not come until the second half of 2013 at the earliest.

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— STOXX 50 euro area bank index



Source: Bloomberg, TrendMacro calculations

—10-year yield spread, Spain minus France



Source: Bloomberg, TrendMacro calculations

- The deposit base of monetary financial institutions (MFIs) in a number of stressed countries has strengthened, allowing those institutions to reduce their reliance on ECB funding.
- Draghi listed how things have recently improved in the euro area saying "Bonds are up, CDS are down, stocks are up, loan redemptions are down, deposits are up and TARGET2 balances have gone down." He went so far as to say there is now "positive contagion" in the euro area.
- But he said that the ECB is not looking at an exit strategy from its easy policy stance yet. While the ECB believes that current funding conditions are satisfactory, the "jury is still out" on whether it can claim success.

Overall, there was very little new for the near term horizon from Draghi.

- He certainly did nothing to signal a rate cut in the near future.
- After the December meeting a rate cut was discussed, and we were expecting one early this year (see "[On the December ECB Policy Decision](#)" December 6, 2012). The tone at this meeting was distinctly different -- this time there was unanimous approval of no rate cut. We think now, absent any major downside shock, the ECB will not cut rates again.
- At the end of this month banks that made use of the €489 billion December 2011 3-year LTRO (see "[Europe's Wall of Liquidity](#)" December 21, 2011) can start to return the money they borrowed. Draghi refused to be drawn out on what the ECB projections for returns would be, but it seems likely that there will be some.
- Demand at the ECB for the other operations -- shorter LTROs and weekly main refinancing operations (MROs) -- has been low, with total outstanding under those operations between €100 and €150 billion.

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Recommended Reading

[Special Report - How Mario Draghi is reshaping Europe's central bank](#)

Andreas Framke, Eva Kuehnen and Sakari Suonine
Reuters
January 9, 2013

[In Appreciation: James M. Buchanan](#)

Donald J. Boudreaux
Wall Street Journal
January 10, 2013

[Why Hagel Was Picked](#)

David Brooks
New York Times
January 7, 2013

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- Even if banks return money they borrowed from the 3-year LTROs early, they will still be able to access the other operations on a full allotment fixed rate basis, so they will not risk running into trouble if market conditions were to deteriorate again.

We believe now that the ECB sees no need for any more policy action, and is willing to take some time to see how things play out in financial markets. It may be that even Draghi has been surprised by the recent improvement in sentiment, but the change in our expectations between this meeting and the last does reveal -- thankfully -- a central bank chief who is willing to change position rapidly as conditions change.

Bottom line

The ECB and the BoE stand pat on monetary policy. The ECB's Mario Draghi was much more upbeat at this conference than he was a month ago -- considering how much financial markets have improved, it was warranted. We are reducing the chances of a rate cut next month from the ECB to close to zero. Absent a major downside surprise in the coming months, the next rate move from the ECB will be up, but that should not come until the second half of 2013 at the earliest. ▶