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MACROCOSM

The EIB, Not the ECB

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Don't laugh: the ECB wants a credit program for Greece to become the euro area template.

In a speech yesterday on lending to euro area small and medium enterprises (SMEs), ECB executive board member Benoit Coeuré said that when it comes to access to credit, "The ECB does not have a magic wand." He meant that it is not the ECB's job to address shortage of credit where that shortage is due to a lack of capital or perceived risk of borrowers.

However -- in a continuance of a recently emerged theme in ECB communications on this issue -- Coeuré pointed to the European Investment Bank (EIB) as a possible source of credit support to SMEs. We have noted Draghi's comments on this at the last week's ECB policy meeting (see "On The April ECB Policy Meeting" April 4, 2013), comments that he repeated after today's eurogroup meeting in Dublin.

If, as it seems to us from public and other sources, an enlarged role for the EIB in peripheral credit creation is envisaged, what form would this take and what would be the likely effect?

- The EIB is an EU27 rather than an euro17 institution. It was created to help in financing infrastructure projects both within the EU and in neighboring countries -- mostly the former Soviet bloc.
- More recently it has taken on an increased role in providing finance as stimulus for jobs and growth within the EU.
- In 2012 it agreed to an "innovative SME guarantee fund in Greece." This fund is basically a fund that provides guarantees for EIB lending to the Greek SME sector channeled through the Greek banks.
- In the case of Greece, the fund is €500 million of unallocated EU structural financing which work out to EIB guarantees for €1 billion of lending to Greek SMEs.
- As the process only began in earnest in late 2012, there is little evidence so far by which to judge its effectiveness.
- It seems that the ECB's intention is to replicate the Greek EIB lending program for other states where reduced SME credit is a problem.

Update to strategic view

ECB, EUROPE STOCKS, EUROPE BONDS: The ECB has decided that credit access problems in the euro area periphery are not bad enough to force it to engage in direct action. Instead it is seeking to enlarge the role of European Investment Bank, using as a model the €1 billion credit guarantee scheme already in place for Greece. While this means there won't be a "magic wand" solution -- nor an accompanying strong, short-term equity rally -- it should lead to continued slow improvement in the situation in the periphery. For now, while peripheral equities are still an attractive long-term turnaround play, peripheral bonds are here-and-now a strong total return play.

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With the Greek program as yet unproven, the market's reaction to an announcement of a widened EIB program is unlikely to be as positive as it would be if there was more direct action from the ECB -- such as the use of "Structural Operations," as we recently discussed (see "Draghi's Troika of Troubles" April 3, 2013). But it now seems that growing the EIB is the most that the ECB is going to do in the short term. Even today, Draghi talked about *reduced* fragmentation in the euro area, meaning that he does not see the current problems as structural -- or at least he does not want to create the impression that they are, thereby denying the necessity for direct ECB action.

Rumors of more direct ECB action -- action that we had expected ourselves -- did lead to a reasonably substantial rally in peripheral euro area stocks in the middle of this week. We think the market will not view growing the EIB as providing much of a short term boost to the periphery.

- However, even if the market does not see it as a *big* positive, it is still a positive. It would -- and we are presuming that such a scheme will be announced in the coming weeks -- add to the creeping improvement in conditions in the periphery.
- To be sure, there are still major problems to be worked through, but unless those problems become structural, the ECB is willing to let the improvement continue at the current sluggish rate.
- Lack of a "magic wand" that will strongly and instantly improve the situation is a disappointment. But the lack of sufficient urgency to move the ECB points to the relative improvement in conditions in the periphery.
- We still are very happy to hold peripheral bonds, even after recent rallies to new highs for Spain -- levels not seen since 2010.
- In peripheral equity markets -- well off their January highs -- there is still an aggressive long-term opportunity to speculate on a fundamental secular turnaround. But without the direct ECB action we had hoped for two week ago, we are much less likely to see a huge improvement in the short term.

Bottom line

The ECB has decided that credit access problems in the euro area periphery are not bad enough to force it to engage in direct action. Instead it is seeking to enlarge the role of European Investment Bank, using as a model the €1 billion credit guarantee scheme already in place for Greece. While this means there won't be a "magic wand" solution -- nor an accompanying strong, short-term equity rally -- it should lead to continued slow improvement in the situation in the periphery. For now, while peripheral equities are still an attractive long-term turnaround play, peripheral bonds are here-and-now a strong total return play.

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