

TRENDMACROLIVE!

## On the June ECB Policy Decision

Thursday, June 6, 2013

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Draghi risks recovery, and his reputation, by not actually doing "whatever it takes."

Today the [European Central Bank kept rates unchanged](#), as expected (see ["On the May ECB Policy Decision"](#) May 2, 2013 and ["Not a Big Bang, But It Could Work"](#) May 29).

But in both his [prepared speech](#) and the [questions and answer session](#) after the announcement of the decision, ECB president Mario Draghi managed to pour cold water on expectations of further actions from the ECB in the short term. That dashed hopes of any immediate ECB solution to the continued failure of recovery in the euro areas periphery -- and in doing so, Draghi managed to undo much of the progress made in sovereign bonds in those markets in the past few months (please see chart below).

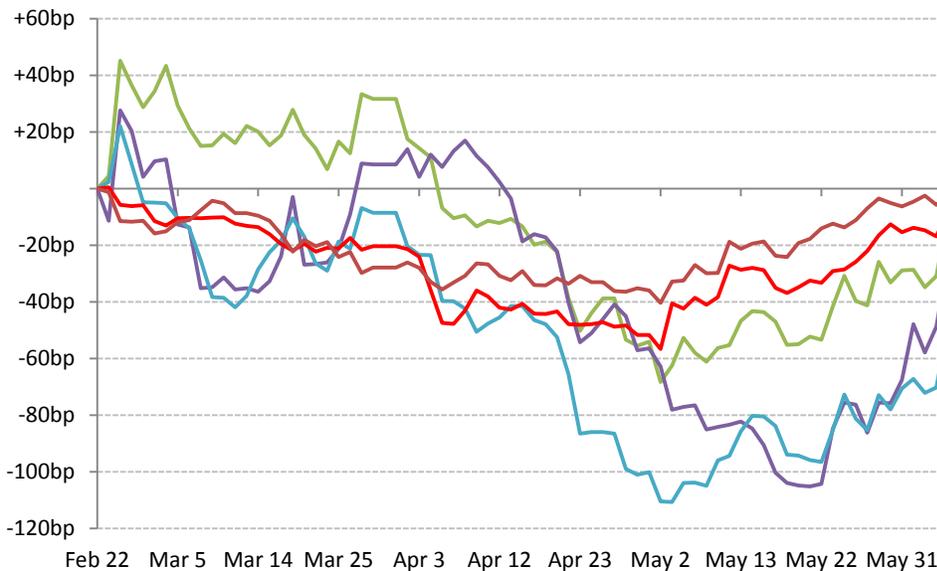
- Without any major policy initiative to announce, this press conference was always going to be close to a non-event.
- But Draghi did discuss the policy measures that may be put into

### Update to strategic view

**ECB:** Draghi disappoints. We didn't think the ECB would go negative on rates today, but Draghi also went to some length to pour cold water on other solutions to the current lack of credit -- and growth -- in the euro area. He boasted about the effectiveness of OMT, seemingly without realizing that it was his "whatever it takes" commitment that really caused the turnaround for the euro area. But being unwilling -- or unable -- to actually do whatever it takes, he puts that recovery at risk.

### 10-year government yield, change from before Italy election

— Germany — France — Italy — Portugal — Spain



Source: Bloomberg, TrendMacro calculations

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action *if they are needed*.

- He said -- again -- that the ECB is technically ready for negative interest rates. We still feel that this is unlikely without a significant deterioration in conditions within the euro area, coupled with an inability by the ECB to agree -- due to internal differences -- to implement anything more substantial.
- Draghi said that among the other possibilities that were discussed was collateral policy -- by which we presume he means allowing new types collateral or reducing haircuts on already eligible collateral.
- Further LTROs were also discussed. This one strikes us as particularly odd -- with fixed-rate full-allocation operations guaranteed to be in place until July 2014 (again, see "[On the May ECB Policy Decision](#)" ) and demand falling for ECB liquidity, it is hard to see what use another LTRO would be.
- Finally, Draghi managed to pour some cold water on what still looks like the most effective solution to credit availability in the periphery - - the establishment of an ABS market based on credits to small- and medium-size enterprises (SME)
- He described the functioning of such an SME ABS market just as we would have expected it -- there would be a guaranteed attached to the ABS, most likely from the European Investment Bank. But then he went on to say that it was not a solution for the short term, and that it probably would not be a large market anyway.

Draghi then went on to boast about how well the Outright Monetary Transactions (OMT) have worked.

- He said, "it's really very hard not to state that OMT's been probably the most successful monetary policy measure undertaken in recent time."
- He then listed the improvements in markets since the OMT was announced, citing rises in the German, Spanish and Italian stock markets, and improving TARGET2 balances across the euro area.
- He said that latest data -- as yet unpublished -- would show that German TARGET2 assets were now lower than they were before the first 3-year LTRO in December 2011.
- He added that those who thought that TARGET2 was a cause for concern should be happy with these numbers.
- It is interesting that Draghi continues to claim victory for OMT -- a policy instrument that has never been used, and one we know very little about -- when it can be argued that it was his 2012 "whatever it takes" speech was the real turnaround moment (see "[On Draghi in London](#)" July 26, 2012) and the positive reaction to OMT was just a symptom of the that.
- By both over-egging the OMT cake, and showing an apparent unwillingness to *actually do* "whatever it takes," Draghi is risking the very high reputation that he has with markets.
- The problems the euro area face have started to fade during 2013, but Draghi is risking a lot by presuming the continuation of the

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current trend if the market no longer trusts or expects him to do what is needed when it is needed.

On a completely different subject, we should note that today was Mervyn King's last Bank of England [monetary policy meeting](#). He has been in charge of the BOE for a decade, and is due to be replaced by Mark Carney on July 1. Whether Carney will make much difference at the BOE -- where QE already totals £375 billion, for very little obvious return -- remains to be seen. The best that can be said for King is that when he came to office, one pound sterling bought \$1.65 and today it buys \$1.55 -- so at least he has managed to maintain the relative value of sterling surprisingly well.

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### **Bottom line**

Draghi disappoints. We didn't think the ECB would go negative on rates today, but Draghi also went to some length to pour cold water on other solutions to the current lack of credit -- and growth -- in the euro area. He boasted about the effectiveness of OMT, seemingly without realizing that it was his "whatever it takes" commitment that really caused the turnaround for the euro area. But being unwilling -- or unable -- to actually do whatever it takes, he puts that recovery at risk. ▶