

MACROCOSM

How's That Working For You, ECB?

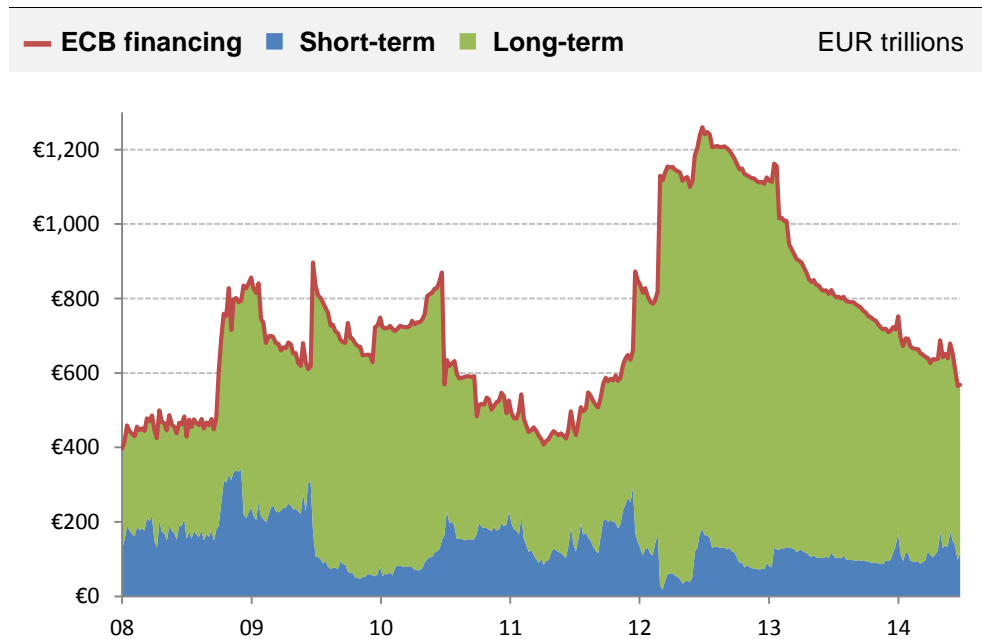
Wednesday, July 2, 2014

Donald Luskin with research input from **Lorcan Roche Kelly**

So many new policies, so few results -- and asset purchases are pushed far into the future.

We expect nothing from tomorrow's European Central Bank policy meeting. And just as we expected (see ["On the ECB June Policy Decision"](#) June 5, 2014), nothing is exactly what has been achieved from last month's kitchen sink barrage of policy initiatives designed to raise inflation, increase bank lending, and weaken the euro.

- Obviously, it's too soon to see any progress on inflation and lending. And euro area banks are no doubt distracted by the capital adequacy risks arising from the upcoming [comprehensive assessment](#) ahead of the introduction of the [Single Supervisory Mechanism](#) in November. That said, it's not encouraging to see that banks have continued to reduce their use of ECB financing -- and quite sharply (please see the chart below).



Source: ECB, TrendMacro calculations

- Exchange rates, on the other hand, can be expected to adjust to policy more quickly, but the ECB can take little joy in the euro's behavior. It's stronger since the imposition last month of negative

Update to strategic view

ECB, EUROPE MACRO:

The ECB will likely announce no new policy measures at tomorrow's policy meeting. And so far, it has nothing to show for last month's barrage of new policy initiatives -- none of which we expect to be effective. With banks distracted by upcoming capital adequacy tests, and the ECB committed to implementing TLTRO's, a broad-based asset purchase program -- the only policy measure with a serious chance of accelerating bank lending -- will be long deferred. In the meantime, Europe's recovery continues, with or without the ECB.

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deposit rates -- though, to grasp at straws, it is indeed weaker than it was the month before that when the ECB broadly hinted that policy actions would be forthcoming (please see the chart below, and "[Draghi Commits to QE](#)" May 9, 2014).

— Euro exchange rate versus USD



Source: Bloomberg, TrendMacro calculations

- Looking ahead, the ECB is running out of policy measures it can implement before it finally is forced to embark on a broad-based asset purchase program. Unfortunately, the move to negative rates and the Targeted Longer-Term Refinancing Operations (TLTRO) coming in September have delayed that policy move until late 2014 at the earliest.
- We continue to believe that a broad-based asset purchase program is the one and only thing the ECB could do at this point that would likely be effective to achieve President Mario Draghi's most cherished objective -- to accelerate bank lending, especially to small and medium-size enterprises in the periphery.
- At the same time, we continue to believe that the euro area is recovering nicely without such additional stimulus. With peripheral Europe having already recovered from the brink of annihilation, and having already paid the adjustment costs to restore their labor competitiveness, we're perfectly happy to be patient.

Bottom line

The ECB will likely announce no new policy measures at tomorrow's policy meeting. And so far, it has nothing to show for last month's barrage of new policy initiatives -- none of which we expect to be effective. With banks distracted by upcoming capital adequacy tests, and the ECB committed to implementing TLTRO's, a broad-based asset purchase program -- the only policy measure with a serious chance of accelerating bank lending -- will be long deferred. In the meantime, Europe's recovery continues, with or without the ECB. ▶

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