

TRENDMACRO LIVE!

## On the November ECB Policy Decision

Thursday, November 8, 2012

**Lorcan Roche Kelly**

**Draghi shows he can do politics as brilliantly as he can do monetary policy.**

For the fifth month in a row, the European Central Bank [left interest rates unchanged](#). Expectations for a cut were low, and considering the continued [lack of demand and constrained supply](#) of credit in the euro area, the efficacy of any cut would have been limited. The continued sluggishness of the euro area credit market can be seen in the lack of M3 money supply growth (please see chart below).

As highlighted in today's press conference following the ECB rate decision, some banks in the euro area are planning to repay [their 3-year LTRO money](#) as early as Q1 2013 as they have no use for the cash. ECB President Mario Draghi said this proves that the LTROs were not inflationary. But, with lending -- and therefore M3 growth, and probably inflation too -- below where it might have been, we feel sure Draghi would actually prefer if the banks held on to the cash in order to lend it into the euro area economy.

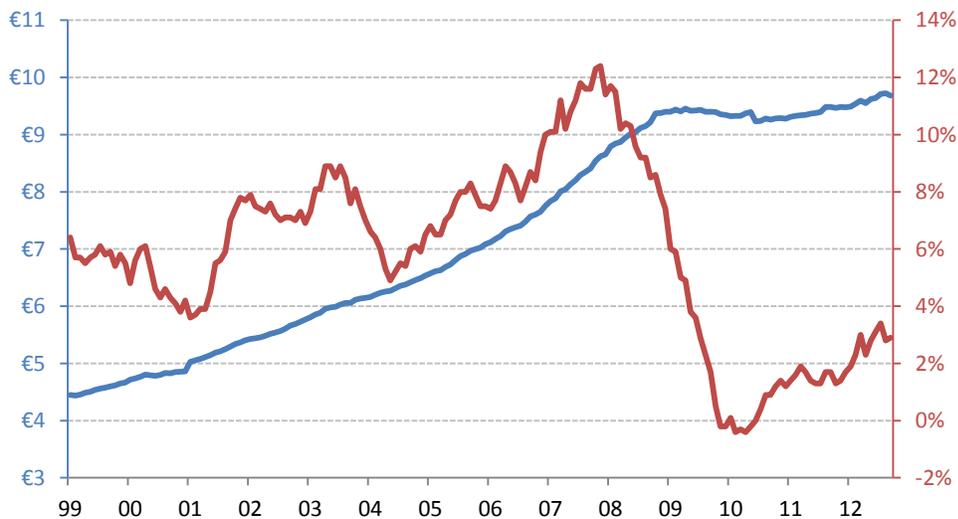
Even if the traditional monetary policy tool -- interest rates -- is ineffective in the current economic climate, the ECB still faces a challenge to its

### Update to strategic view

**ECB, EUROPE MACRO:**  
 No change at the ECB. With lending remaining subdued in the euro area, and below-target inflation projected for both 2013 and 2014, Mario Draghi has to play politics. Through his very public pronouncements on the German economy he is telling his strongest opponents that looser ECB policy will benefit them, too.

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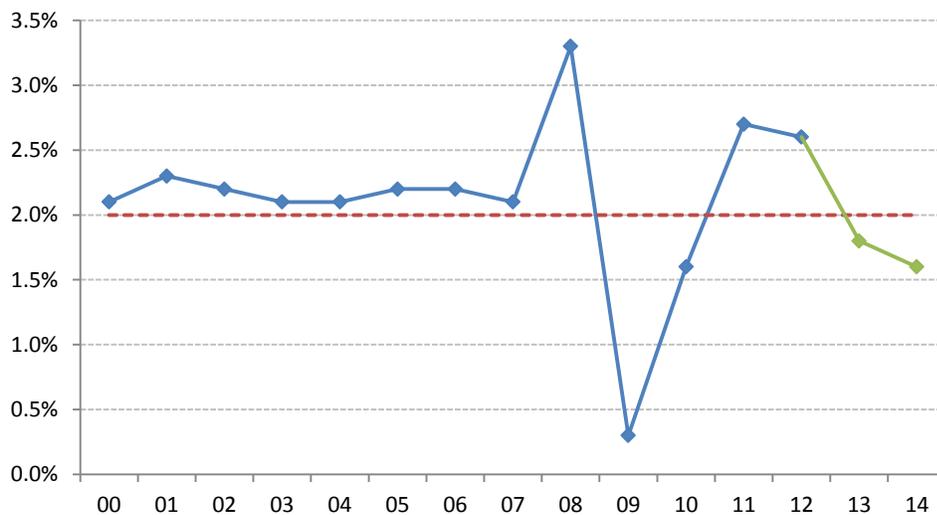
**Euro M3 Money Supply** — Level, EUR trillions — Change, YOY



Source: ECB, TrendMacro calculations

primary inflation mandate. The ECB's inflation target has [always been described](#) as "close to, but below 2%." While inflation is currently running above 2%, [both ECB](#) and yesterday's [European Commission](#) projections point to inflation at 1.6% in 2014 (please see the chart below).

**Euro area inflation (HICP)** ◆ Actual ◆ Forecasted --- ECB target



Source: ECB, EU Commission, TrendMacro calculations

The ECB under Mario Draghi has to be looser in order to counteract these disinflationary pressures. But for Draghi, the ability to pursue looser monetary policy comes under political pressures that no other central banker faces. The main source of that pressure is Germany. In the last two weeks, Draghi -- who is thankfully a great politician as well as a great central banker -- has been concentrating his efforts on German public opinion.

- On [October 24](#) he addressed the German parliament (see "[Calm Breaks Out in Europe](#)" October 31, 2012), attempting to ease worries about the ECB's latest bond buying program, Outright Monetary Transactions (OMT). He said then that OMT would counter deflation risks without being inflationary.
- He followed this with an interview with German magazine [Der Spiegel](#) and, yesterday, an address to [German business owners](#). In that speech Draghi highlighted the risks to the German economy from the continued crisis -- comments that moved [German stocks lower](#).
- Draghi's warning to the Germans is a powerful one. They have resisted -- or at least oppose -- his measures thus far based on an idea that the euro crisis was something happening somewhere else. By making it clear in a very public way that Germany is set to suffer too, Draghi may be able to move German opinion on monetary policy away from the ideological basis it has been built on thus far, to something more pragmatic.
- If Draghi is successful in his ongoing campaign to convince the Germans that the crisis is not going to pass them by, and that the

**Contact  
TrendMacro**

On the web at [trendmacro.com](http://trendmacro.com)

Follow us on Twitter at [twitter.com/TweetMacro](https://twitter.com/TweetMacro)

Donald Luskin  
Chicago IL  
312 273 6766  
[don@trendmacro.com](mailto:don@trendmacro.com)

Thomas Demas  
Charlotte NC  
704 552 3625  
[tdemas@trendmacro.com](mailto:tdemas@trendmacro.com)

Lorcan Roche Kelly  
Sixmilebridge Ireland  
212 537 9067  
[lorcan@trendmacro.com](mailto:lorcan@trendmacro.com)

John Clinton  
Charlotte NC  
704 552 3629  
[jclinton@trendmacro.com](mailto:jclinton@trendmacro.com)

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ECB is the institution to ease the crisis, then he will have managed to reduce the pressure on his ability to take the decisions he feels necessary -- to pursue looser policy than the Germans would otherwise accept.

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**Bottom line**

No change at the ECB. With lending remaining subdued in the euro area, and below-target inflation projected for both 2013 and 2014, Mario Draghi has to play politics. Through his very public pronouncements on the German economy he is telling his strongest opponents that looser ECB policy will benefit them, too. ▶