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TRENDMACRO LIVE!

On the March ECB Policy Decision

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Is an easier ECB what the euro area needs? Even Draghi doesn't really believe that.

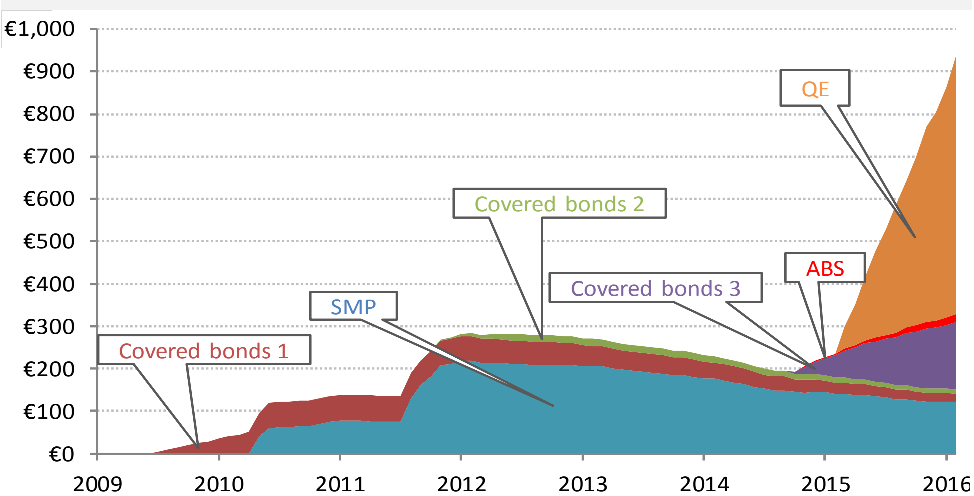
The European Central Bank announced this morning significant new easing measures, including:

- Deepening the negative interest rate on deposits to 40 bp
- Reducing the main refinancing rate to zero
- Expansion of quantitative easing to €80 billion per month
- Inclusion of non-bank corporate bonds in QE
- New Targeted Long Term Refinancing Operations with 4-year term, at a fixed rate potentially below zero

The immediate reaction in markets is quite positive, so far be it for us to look a gift-horse in the mouth. That said, it strikes us that this new policy package is an emphatic attempt to answer a question that's not worth asking any more: is Europe's growth really being held back because the ECB hasn't been easy enough?

- Even ECB President Mario Draghi in his press conference today did not cite the insufficiency of ECB accommodation as an explanation for why "economic recovery in the euro area continues to be dampened."

European Central Bank asset purchase programs EUR billions



Source: ECB, TrendMacro calculations

Update to strategic view

ECB, EUROPE MACRO, US FED, FX, ASIA MACRO: The ECB took deposit rates more deeply negative, lowered the main rate to zero, increased QE purchases and expanded them to include non-bank corporates, and introduced new sub-zero-rate TLTROs. By cheapening the euro, these moves exacerbate the over-valuation of China's currency. Since euro area banks are capital-constrained, punishing them with negative rates for not lending is a dead-weight cost. By pretending to be helpful, the ECB eases the sense of crisis that is the only effective goad to necessary structural reforms in the euro area. The only good that can come of this is that it might slow down further ill-advised rate hikes from the Fed.

- Instead, he called out “subdued growth prospects in emerging markets…balance sheet adjustments in a number of sectors and the sluggish pace of implementation of structural reforms.”
- *ECB policy that weakens the euro won’t help “growth prospects in emerging markets,” especially China*, whose currency-management strategy now is focused on healing the excessive valuation of the RMB versus the euro (see [“Yuan Direction”](#) February 16, 2016).
- *Banks in the euro area are not reserves-constrained, they are capital-constrained* – especially under the European Union’s newly implemented version of Dodd-Frank, the [Bank Recovery and Resolution Directive](#). They must make, at great cost, what Draghi refers to as “balance sheet adjustments.” *In the meantime, since they cannot lend, then more-negative deposit rates are a dead-weight cost that further erodes their already inadequate capital.*
- *As to “structural reforms” – by which Draghi means liberalization of labor and product markets – the euro area will only do such things under the lash of crisis. To the extent that the comforting glow of ECB accommodation relaxes the sense of crisis, so does it slow the progress of reform.* For example, in the pit of the euro area’s debt and banking crisis, Spain elected Thatcherite reformer Mariano Rajoy by the largest landslide in that nation’s electoral history – and he has transformed Spain into the fastest-growing large developed economy in the world. Now, without the discipline of crisis, Rajoy’s *Partido Popular* failed to earn enough seats in December’s general election to form a governing coalition. “Structural reforms” in Spain – even where they have worked better than anywhere else in Europe – are on hold indefinitely.
- *And if “structural reforms” are what Draghi seeks, it is surely a step in the wrong direction to have the ECB – effectively acting as the euro area’s federal government – transforming monetary policy into industrial policy by buying corporate bonds.*

The only good we can see coming from this is that it throws the Fed’s “liftoff” process into even sharper contrast with the policy postures of the rest of the world’s major central banks. For [fear of excessively strengthening the dollar](#) and unmooring long-term inflation expectations that are already at the lowest in the history of the data, the Fed may now be slightly more cautious in its timing of continued ill-advised rate hikes.

Bottom line

The ECB took deposit rates more deeply negative, lowered the main rate to zero, increased QE purchases and expanded them to include non-bank corporates, and introduced new sub-zero-rate TLTROs. By cheapening the euro, these moves exacerbate the over-valuation of China’s currency. Since euro area banks are capital-constrained, punishing them with negative rates for not lending is a dead-weight cost. By pretending to be helpful, the ECB eases the sense of crisis that is the only effective goad to necessary structural reforms in the euro area. The only good that can come of this is that it might slow down further ill-advised rate hikes from the Fed.

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