The ECB - More Fuel for the Fire

• Data underpin the case for fresh ECB stimulus...
• ... and for a joint delivery via a weaker EUR
• But can the ECB fight a recession without assistance?

Eurozone economic data underpin the case for fresh ECB stimulus and for a joint delivery via a weaker EUR.

Swathes of the eurozone are sliding into a deepening industrial recession. Germany’s July PMI has slumped to its lowest level in seven years and at 43.1, the index was far below expectations of 45.2.

The French index fell to 50.0 from 51.9 – also far below expectations – and the pan eurozone figure now stands at 46.4.

Nevertheless, at 53.3, a separate PMI from Markit is pointing to steady, albeit modest growth outside of manufacturing; and data released alongside the PMIs yesterday confirmed that bank lending to corporates and households continues to grow – albeit skewed, geographically - at a fairly steady pace.

This is not to suggest that non-manufacturing is thriving of course, but the distinction of an "industrial" recession may be important when it comes to policy emphasis.

The ECB could choose to make the next round of TLTROs

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1. RBA’s Lowe: "Reasonable to expect an extended period of low interest rates" >

2. AFR claims Australian Treasury looking into changes to the RBA’s inflation target >
more generous, but continuing to target the means by which banks create credit in itself is unlikely to seriously alter the inflation outlook for the eurozone.

Indeed, the risk is that the ECB is seen to be pushing even harder on the very same string.

The distinction of an "industrial" recession may be important when it comes to policy emphasis

In fact, many policy options pose the very same risk and bring with them additional complications: on the return to QE, the ECB would have to circumvent its own rules pertaining to the ownership of more than one-third of a country’s debt; rate cuts would have to be accompanied, it is thought, by a tiered deposit rate to minimize distortions.

But assuming that the ECB plumps for one of these options, it could be seen to miss its preferred target if its policy shift fails to deliver a boost to industry and its exporters by the most potent means possible – a weaker EUR.

And certainly, there is a means by which this could be possibly achieved as part of a far bigger challenge: persuading the market that its policies can accomplish what its past policy endeavors have failed to do – namely secure a sustained rise in the eurozone inflation rate.

The notion of lower for longer rates would surely be well received by EUR bears

Indeed, the ECB is thought to be pondering a modification to its inflation guidance for that very reason.

There has been talk for some time that a number of Council officials are looking for a more emphatic way of spelling out the ECB’s seriousness of intent in hitting the
target. And such a shift in guidance could feasibly entail the elimination of any talk of a hike.

Moreover, if talk of a more "symmetric" approach to the inflation target is prescient, the ECB could also convey a greater tolerance of any overshoot of 2% – something alluded to by both former Bank of Finland Governor Erkki Liikanen and incumbent Olli Rehn in recent times.

Well, the notion of lower for longer rates would surely be well received by EUR bears.

Ultimately, however, a bigger question hangs over the eurozone: can the ECB fight a recession without the greater assistance from fiscal policy that has (so often) been sought by Mario Draghi, but was last week denied him by Angel Merkel?

Former IMF chief economist Olivier Blanchard for one thinks not.

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