Eurozone

ECB: the status quo, for the time being

■ **The ECB maintained the monetary status quo while at the same time announcing an upcoming change in the parameters of QE. Concretely, it is a matter of determining which parameters of its securities purchase programme should be modified to cope with the inevitable shortage of German securities in the future, assuming rates hold at current levels.**

■ **Depending on the options that are chosen, changing the parameters of QE provides the ECB with an opportunity to ease monetary policy to varying degrees, without necessarily increasing the pace of monthly purchases. It appears the ECB wanted to hold onto this "card" for the year-end period, once there is much greater visibility over the scope of Brexit's impact on European activity.**

■ **As he has after each monetary policy meeting, although this time with greater insistence, Mario Draghi reiterated the need to adopt structural reforms and a fiscal policy that promotes growth in order to "reap the full benefits" of monetary support.**

Despite the slight downward revision of growth forecasts and the persistent sluggishness of core inflation, the ECB maintained the monetary status quo in September. In particular, it maintained the indicative end date for the asset purchase programme at March 2017. During the press conference, Mario Draghi revealed that the Governing Council had not even discussed the possibility of extending the programme. The other key point from the meeting is the creation of Task Committees to assess the options for a smooth implementation of the purchase programme. Concretely, it is a matter of determining which parameters of the QE programme should be modified to cope with the inevitable scarcity issue, assuming rates hold at current levels.

This point is vital for understanding the monetary status quo. If the ECB were to announce an extension of QE, it would inevitably have raised questions about the technical constraints of its implementation, forcing the central bank to spell out its intentions in greater detail. Yet clearly the ECB is still working on a consensus view on this question. Another possibility is that the monetary institution wants to give itself time to think things through. Depending on the options that are chosen, changing the parameters of QE provides the ECB with an opportunity to ease monetary policy to varying degrees, without necessarily increasing the pace of monthly purchases. It appears that the ECB wanted to hold onto this "card" until the year-end period, once there is much greater visibility over the scope of Brexit's impact on European activity.

A sharp slowdown in growth and inflation could give rise to a major change in the distribution key for debt purchases (which today is based on each member state's contribution to the ECB's capital), which would specifically target the countries experiencing the greatest difficulties, or by adopting new criteria (purchases in proportion to the amount of public debt). This would significantly increase the effectiveness of QE. Inversely, if economic activity is more in line with forecasts, it could be accompanied by less radical changes, such as an increase in the issue share limits (from 33% to 50%), and limited deviation from the existing capital key (without calling it into question), notably by resorting to greater substitution purchases (supranational securities) in jurisdictions facing shortages.

The door is still open for an extension of QE beyond March 2017, as this horizon has always been considered as the minimum duration for securities purchases at the current pace. From Day 1, it was clearly established that the QE programme is open-ended, that is to say it would continue as long as inflation had not returned to a satisfactory trajectory. It is also worth noting that in its first draft, QE was initially supposed to end in September 2016… Unless inflation picks up more rapidly than expected by the end of the year, we continue to expect securities purchases to continue at the current pace of EUR 80bn a month beyond March 2017, and at least through September 2017.

So far, European activity has been rather resilient. The ECB lowered its growth forecast only slightly (-0.1 pp in 2017 and 2018), and growth is still expected to exceed its long-term potential rate. Yet as Mr. Draghi has insistently repeated, this resilience is largely due to the monetary support provided by the ECB, which is the underlying assumption of all forecasting. It is essential to maintain a very accommodating monetary policy in the years ahead, and that will require changing the parameters of the assets purchase programme, which could lead to further monetary easing. According to Mr. Draghi, "the transmission of the monetary policy has never worked better than it does today", which brushes aside any claims that the impact of the measures taken since mid-2014 are winding down.

Yet Mr. Draghi reiterated, as he has after each monetary policy meeting, but this time with extra insistence, the need to adopt structural reforms and a fiscal policy that promotes growth in order to "reap the full benefits" of monetary support. Pushed on several occasions to spell out his thoughts during the press conference, Mr. Draghi unambiguously called for a more expansionist fiscal policy in Germany: "Countries that have fiscal space should use it. Germany has fiscal space". More generally, concerning the support expected from fiscal policy to promote growth, Mr. Draghi esteems that the composition of fiscal policy is more important than its size, a notion that could apply just as well to the ECB's future monetary policy, in the light of the challenges of changing the parameters of QE in the future.