

ECO FLASH

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ECB: targeted measures and flexibility of instruments

Louis Boisset

- The ECB announced a new series of measures to counter the economic consequences of the Coronavirus pandemic.
- The Governing Council is seeking to maximize the impact of its actions by opting for targeted measures.
- It is paying special attention to the risk that monetary and financial conditions could tighten.
- Despite communication missteps, the ECB has expressed its determination and has called on governments to take concerted action.

Targeted measures and looser financing conditions

Faced with the economic shock of the coronavirus pandemic, the European Central Bank (ECB) has acknowledged the major downside risks associated with its macroeconomic scenario for the eurozone. The central bank lowered its projections, notably for 2020, with eurozone GDP growth now expected to 0.8%, down from its previous forecast of 1.1% in December 2019. However, given the deadline for making projections, the ECB scenario only integrates a small part of the Coronavirus shock, and activity could be much less dynamic¹.

Under these circumstances, the ECB unanimously decided to implement several measures:

- The conditions applied to targeted longer-term refinancing operations (TLTRO III) with eurozone banks would be eased, with rates lowered to -0.75% (25bp less than the deposit facility rate).

¹ For example, the ECB's technical assumption for oil prices in 2020 is USD 56.4 per barrel. Yet given current oil market pressures and the level of oil prices, the average annual price could be much lower this year.

These TLTRO will apply between June 2020 and June 2021;

- Alongside quantitative easing (the existing securities purchasing programme), an additional EUR 120 bn will be allocated by the end of the year, specifically to respond to the current crisis. These extra funds provide some flexibility, since the Board did not announce any monthly purchasing amounts. More importantly, the additional funds will target primarily the private sector.
- Additional longer-term refinancing operations will be carried out temporarily and on a weekly basis through the end of June 2020 (date of the next TLTRO III operation). The ECB president explained that even though there were no signs of a liquidity squeeze, these operations would serve as a safeguard in case financial conditions were to tighten.

Contrary to market expectations, the ECB opted not to lower key rates again. President Lagarde said that rate cuts would not be as effective as the announced measures. Indeed, targeted measures are a better tool for responding to the current shock. An interest rate cut has only a very mild impact in case of exogenous shocks or supply-side difficulties.

Questions persist

President Lagarde insisted that the ECB would use all of the flexibility available through its securities purchasing programme. It might possibly decide to deviate from the issuer limit² of 33%, but this level still seems to be the rule to follow. For the moment, the ECB has excluded the possibility of raising this limit.

² The ECB cannot purchase more than 33% of an issuer's outstanding securities.

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Despite some mixed communications³ and markets' immediate show of disappointment, the ECB has taken action and seems ready to play a greater role if needed to defend the Eurozone economy during this crisis.

Once again, Christine Lagarde has called on the eurozone member states to act in a co-ordinated and ambitious manner.

The latest government announcements seem to be moving in the right direction. Avoiding an economic recession will rely on public policy interventions and fiscal policy actions in particular.

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³ President Lagarde initially said that it was not the ECB's role to intervene concerning sovereign yield spreads. She immediately revised her position following the meeting.

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