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CENTRAL BANKS

## As Fed Preps a Rate Cut, ECB Weighs Stimulus of Its Own

Relaunching quantitative easing could trigger fresh tensions between the ECB and Germany



The ECB's key interest rate is lower than the Federal Reserve's, giving policy makers less room for maneuver. PHOTO: ALEX KRAUS/BLOOMBERG NEWS

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TEXT

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The eurozone's \$13 trillion economy is faltering, buffeted by trade tensions and international uncertainties. Germany's mighty export machine is stalling and the political situation in Italy remains volatile.

European Central Bank officials are preparing to step up with fresh stimulus, echoing similar signals by the Federal Reserve and other central banks. The question for investors is, when, and how, will the ECB act?

Financial markets are evenly split over whether the ECB will move Thursday to support sluggish growth, by cutting its key interest rate for the first time since March 2016, or wait until its following policy meeting on Sept. 12. With some economic indicators flashing red, an early rate cut would be an aggressive signal of intent, coming ahead of a likely quarter-percentage-point cut by the Fed next week.

Here are five things to watch from the decision and ECB President Mario Draghi's press conference:

### **Rate Cut**

The ECB's key interest rate is almost 3 percentage points lower than the Fed's, at minus 0.4%, giving ECB policy makers less room for maneuver. An early rate cut could deliver an extra kick by weakening the euro's exchange rate. Investors see a 50% chance that the ECB will announce a 0.1 percentage-point cut Thursday, with the remainder expecting the same move in September.

A deeper cut is possible and some analysts expect the ECB to unveil a plan aimed at limiting the cost of negative rates for eurozone banks.

### **Bond Buys**

The ECB phased out its giant bond-buying program, known as quantitative easing, in December, but Mr. Draghi has signaled recently that the program could be revived. Many analysts expect a relaunch as soon as September, with the ECB pledging to buy hundreds of billions of euros of government and corporate debt. If so, it would probably need to loosen self-imposed rules that restrict it from buying more than 33% of any individual government's debt.

Mr. Draghi could say at his press conference Thursday that he has asked ECB staff to examine the technical parameters of a fresh program, a clear hint that QE is imminent.

### **Inflation Target**

ECB officials have suggested recently that they could tweak the bank's inflation target. Currently, the ECB aims to keep inflation just below 2%, but officials have indicated they might try to overshoot the target for a while, which would call for bolder stimulus policies. Mr. Draghi could flesh out such strategic considerations Thursday, although investors might question the credibility of any changes given that the ECB has failed to even hit its current target.

### **Other Assets**

Given the limited stock of eurozone government debt, especially German bunds, some investors expect the ECB to start buying other assets. One option would be to buy stocks, a move pioneered by the Bank of Japan. Any hint that ECB officials are considering such a move would light a fire under European stock markets.

### **What About Germany?**

Relaunching QE could trigger fresh tensions between the ECB and Germany, the region's largest economy. German officials, including Bundesbank President Jens Weidmann, have chafed at the ECB's bond purchases, which they worry subsidize profligate eurozone governments. Mr. Weidmann has backed twin moves by the ECB this year to lengthen to time horizon for its next rate increase—effectively easing its policy—but he may draw a line at bond purchases.

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