Draghi Reinforces ECB Stimulus Momentum to Assuage Investors

By Simon Kennedy and Stefan Riecher - Nov 6, 2014

Mario Draghi is stoking investor bets that he'll intensify stimulus for the euro area after indicating he has the backing of policy makers to do so.

With the European Central Bank president yesterday downplaying dissent within his 24-member Governing Council, new preparations for more-expansive action and a 1 trillion euro ($1.2 trillion) target for boosting the institution's balance sheet suggest momentum is shifting toward a proposal for broader bond-buying, perhaps in December.

The euro fell and southern European bonds rose as Draghi said policy makers are united in trying to revive inflation and highlighted how they're stepping up their efforts as the U.S. Federal Reserve pulls back. Corporate bonds could be the next target before more-controversial sovereign debt, economists said.

“Draghi signaled that additional monetary easing was in the pipeline,” said Nick Kounis, head of macro and financial markets research at ABN Amro Bank NV in Amsterdam. “Further action could be announced as soon as next month’s meeting.”

The euro area’s central bankers met yesterday in Frankfurt amid claims that Draghi often acts without the backing of them all, and just days after the Bank of Japan ramped up its own stimulus campaign. The question from investors is how much more he can do to boost an economy that risks sliding into its third recession in six years and where inflation is close to becoming deflation.

Trillion Euros

Having already cut interest rates to record lows and saying they can go no lower, Draghi is now focused on boosting the ECB’s balance sheet. He told reporters that he expects to increase assets back toward March 2012 levels, a clearer commitment than previously. That means a goal of 3 trillion euros, or about 1 trillion euros more than the current level.

The ECB has issued long-term loans to banks and started buying covered bonds in the hope of flooding the economy with enough liquidity to ease credit constraints. Purchases of asset-backed securities are due to start this month.

That won’t be enough and if the ECB is serious about boosting its balance sheet it will need to snap
up corporate bonds, securities from agencies such as the European Investment Bank and ultimately government debt, said Andrew Bosomworth, managing director at Pacific Investment Management Co. in Munich and a former ECB economist.

‘Quite Confident’

“From an economic perspective, households and corporations should feel more convinced that the ECB is serious about reflating the euro-zone economy,” he said. “From an investment perspective, investors should also feel more convinced that the euro will depreciate further.”

The euro slid to a two-year low after Draghi spoke. Spanish and Italian bond yields dropped and European stocks gained.

“We are quite confident that the impact on our balance sheet size will be adequate, will be significant, will be sizable,” Draghi said. “The main message is that our balance sheet will keep expanding in the coming months and will continue expanding while the balance sheets of other central banks is bound to contract.”

The Fed last week announced it had stopped its third round of quantitative easing. In contrast, the Bank of Japan increased its program of bond purchases last week, putting pressure on Draghi to follow.

Paris Conference

Bank of Japan Governor Haruhiko Kuroda and Fed Chair Janet Yellen are among those speaking at a Paris conference of policy makers today, which will include ECB officials such as Executive Board member Benoit Coeure and Bundesbank President Jens Weidmann.

The trigger for further ECB action may be its updated economic outlook, which will be unveiled at the December press conference. Draghi said today he sees indications that the forecasts will be cut.

That may still be too soon, according to Mark Wall and Marco Stringa, economists at Deutsche Bank AG in London. Draghi said action would come only if current policies are deemed insufficient to reach the balance-sheet target and the economic outlook worsens.

“A December move cannot be fully discounted, but it is not in line with our understanding of the two contingencies,” the Deutsche economists said, adding they still expect the ECB to buy government bonds in the first quarter of next year.

Testing Limits

That would prove controversial given German-led arguments that buying sovereign debt relieves pressure on politicians to shake up their economies, and in the worst case violates a ban on monetary financing of governments.
It would test the limits of Draghi’s ability to push through radical measures. Reuters reported on Nov. 4 that as many as 10 Governing Council members might oppose sovereign-debt purchases even should inflation weaken.

Draghi said he isn’t operating a “kitchen cabinet” and and that no “coalitions” are forming within the Governing Council. He said his opening statement yesterday was signed by all the members of the decision-making body.

“It’s fairly normal to disagree about things,” he said. “Read recent statements about when to raise interest rates in the U.S. It happens in the U.K., it happens in Japan. This is part of normal diversity.”

To contact the reporters on this story: Simon Kennedy in London at skennedy4@bloomberg.net; Stefan Riecher in Frankfurt at sriecher@bloomberg.net

To contact the editors responsible for this story: Fergal O’Brien at fobrien@bloomberg.net Paul Gordon, Craig Stirling

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