The European Central Bank kept interest rates unchanged at record lows as investors wait for President Mario Draghi to signal how close officials are to adding more stimulus.

The 24-member Governing Council left the main refinancing rate at 0.05 percent at its meeting today in Frankfurt. The decision was predicted by all 54 economists in a Bloomberg News survey. The deposit rate remained at minus 0.2 percent and the marginal lending rate at 0.3 percent.

Draghi’s press conference at 2:30 p.m., the first at the ECB’s new premises in the city’s east end, gives him the chance to reassure investors that officials can act quickly if needed to reinvigorate the euro-area recovery. While he pledged last month to raise inflation (ECCPEST) “as fast as possible,” multiple policy makers have since urged a wait-and-see approach to gauge the effect of current stimulus.

“These two positions could be reconciled by a pre-announcement of an unspecified widening of the scope of the ECB’s asset purchases,” said Robert Kuenzel, an economist at Daiwa Capital Markets Europe Ltd. in London. “This would make today’s outcome evolutionary rather than revolutionary.”

**Slowing Inflation**

Draghi said after the November meeting that ECB committees have been tasked with the “timely preparation” of further measures. Those may include purchases of corporate or agency bonds, or full-blown quantitative easing by buying government debt.

His push toward more stimulus comes just as the U.S. Federal Reserve and Bank of England consider when to tighten their monetary policies. The BOE kept its key interest rate at a record-low 0.5 percent in London today, while its bond-purchase plan stayed at 375 billion pounds ($588 billion).

The 18-nation euro area is suffering from mediocre economic growth and an unemployment rate of 11.5 percent that weigh on consumer prices. Inflation slowed to 0.3 percent last month, matching a five-year low, and further deceleration is likely after a 26 percent slump in the price of crude oil this quarter.
The ECB will release fresh forecasts today. In September, it estimated gross domestic product would rise 0.9 percent this year, 1.6 percent in 2015 and 1.9 percent in 2016. Inflation was forecast to accelerate to 1.1 percent next year from 0.6 percent in 2014, and to 1.4 percent in 2016.

**Lonely Defense**

“We are particularly interested in the angle that it takes on the sharp fall in oil prices,” said Helen Haworth, a strategist at Credit Suisse Group AG in London. “Being a short-term negative for headline inflation, it could be used as a rationale to expedite QE.”

The ECB’s challenge is that as governments struggle to convince their electorates of the need for economic reforms and haggle over fiscal stimulus, it is left as a lonely defense against further deterioration.

In response, policy makers have committed to swelling the central bank’s balance sheet toward early-2012 levels, or about 3 trillion euros ($3.7 trillion) compared with 2 trillion euros currently. That would increase the amount of money in the economy in a bid to spur growth and inflation.

**Stimulus Jigsaw**

Programs to buy covered bonds and asset-backed securities started in recent weeks, and the next piece of the stimulus jigsaw is a second round of long-term loans to banks linked to their real-economy lending. After a disappointing uptake of 82.6 billion euros in the first round in September, funding in the Dec. 11 operation could be around 170 billion euros, according to economists surveyed by Bloomberg last month.

It may not be enough. Without broad-based buying of government bonds, the ECB will only be able to boost its balance sheet to 2.6 trillion euros at most by the end of next year, said Andrew Bosomworth, a money manager at Pacific Investment Management Co. in Munich.

“It’s an asset-purchase program of 500 billion euros, in addition to existing policies, would increase the ECB’s balance sheet back to its early 2012 level,” he said in a note to clients, adding that government bonds should form the largest component of the program. “However, purchases of investment-grade corporate bonds, agency bonds, blue-chip stocks and gold should also be considered.”

**QE Pushback**

While Draghi was able to announce last month that his council was “unanimous” in its balance-sheet stance, that accord splinters once sovereign debt is brought into the mix.

Sabine Lautenschlaeger, the German member of the six-person Executive Board, last week became one of the most-prominent members of the council to reject that prospect. She said the “purchase of government securities is inevitably linked to a serious incentive problem” by depressing
borrowing costs for funding national budgets.

Her comments came after Governing Council member Jens Weidmann, who heads Germany’s Bundesbank, said he sees “high legal hurdles” for the buying of government debt.

Even policy makers who view quantitative easing more favorably have signaled the time is not yet ripe. ECB Vice President Vitor Constancio said on Nov. 26 that the measure may be considered in the first quarter of 2015, allowing time to gauge the effect of current stimulus. Executive Board member Benoit Coeure said in a Bloomberg Television interview that officials are “not going to rush” to a decision.

“Draghi would likely ideally want a strong supportive majority,” said Howard Archer, an economist at IHS Global Insight in London. “There is clearly still appreciable reluctance among some ECB's Governing Council members to engage in full-blown QE.”

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