ECB sticks to stimulus exit, downplaying uncertainties

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The European Central Bank stuck to plans yesterday to claw back unprecedented stimulus, even as the growth outlook continues to darken and political turmoil in Italy looms large over the currency bloc.

Having exhausted much of its firepower with years of support, the ECB reaffirmed that its €2.6tn ($3tn) asset purchase scheme will end this year and interest rates could rise after next summer, sticking to guidance first unveiled in June and repeated at every meeting since.

While he acknowledged a loss of growth momentum and a “bunch of uncertainties” from trade protectionism and market volatility, ECB President Mario Draghi played down concerns, arguing that the eurozone was merely returning to a normal or natural pace of expansion after an exceptional 2017.

“We’re talking about weaker momentum, not a downturn,” Draghi told a news conference after policymakers decided to maintain a long-standing assessment that growth risks were “broadly balanced".

"Is this enough of a change to make us change the baseline scenario? The answer is 'No'," he said, adding that the ECB did not even contemplate extending its bond purchase programme, which has depressed borrowing costs and revived growth.

The comments appeared to confirm already solid expectations that the ECB will not go back on its pledge to end bond purchases by the close of the year, even if the growth outlook continues to weaken.

"The ECB remains highly determined to bring net asset purchases to an end," ING economist Carsten Brzeski said."

It would require a severe downturn of the economy, not only weaker momentum, in the coming six weeks for the ECB to alter its course."

Focusing on inflation, the bank's primary mandate, Draghi struck a positive tone, arguing that wage growth was a "very comforting" sign and that policymakers remained confident that price growth will rise.

But despite the hawkish message – which included an upbeat assessment of firmer wage pressures – the euro slipped on his comment that Europe's monetary union remained "fragile" as long as measures to shore up existing structures were not complete.

"And when I say completed, I mean the banking union, I mean the capital market union," he added of measures initiated as a result of the sovereign debt crisis of almost a decade ago but which have foundered on a lack of consensus among member states.

The single currency slipped 0.1% on the day to $1.138 after having earlier reached a session-high of $1.143.

With the EU having taken the unprecedented step of rejecting Italy's budget this week, Draghi was quizzed at length about the escalating political fight between Rome and Brussels.

He made it abundantly clear that the ECB would not come to Italy's aid.

Himself an Italian, Draghi said he was confident compromise

would be reached between Brussels and Rome and noted how much the stand-off was already costing Italy because of the rising yield on its government debt.
“Our mandate… is a mandate towards price stability, not towards financing governments’ deficits,” Draghi said.
He said rising bond yields were already eating into Italy’s fiscal capacity, suggesting that attempts to raise spending would be counterproductive as investors will punish Rome for spending too much.
With a debt to GDP ratio of 130%, Italy is the eurozone’s second most indebted country after Greece, and under its rejected budget proposal, this debt level is unlikely to fall.
“I’m still confident an agreement will be found,” Draghi added.
Asked about the risk that a fall in the value of Italian government bonds could erode the capital positions of some banks that hold them, he said: “I don’t have a crystal ball…
These bonds are in the banks’ portfolios.
They are denting into the capital position of the banks.
Economists said the message to Rome was clear: that the ECB will not come to its aid and it should prepare for life after years of central bank support.
“The ECB is not about to run to Italy’s rescue, even if market conditions deteriorated further,” Nordea economist Jan von Gerich said.