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Visco Says ECB May Not Need to Add Stimulus Amid Euro Decline

By Jana Randow Sep 22, 2014

The European Central Bank may not need to add stimulus measures after steps in the past three months pushed down the euro, said Governing Council member Ignazio Visco.

“Inflation expectations have to be back where they were,” Visco said Sept. 20 in an interview in Cairns, Australia, where he attended a meeting of Group of 20 finance chiefs. “This doesn’t mean that there will be a next step. We have been bold enough to reduce interest rates to a level that was unexpected to the market.”

The single currency has dropped about 6 percent since early June, when the ECB introduced a negative interest rate on excess reserves and presented a four-year lending program to fuel credit. Policy makers reduced borrowing costs further earlier this month and committed to buying asset-backed securities and covered bonds to boost the ECB’s balance sheet by as much as 1 trillion euros ($1.3 trillion).

The extent of the exchange rate’s fall is “more or less, given the moves that were done between June and September, the right response,” said Visco, who also heads Italy’s central bank. The ECB isn’t targeting any exchange-rate level, he said.

‘Some Misunderstanding’

In the first of eight liquidity offers linked to banks’ loan books, dubbed TLTROs, the ECB allotted 82.6 billion euros last week, less than all predictions in a Bloomberg News survey. That sparked speculation among economists and investors that the ECB could be forced to resort to large-scale sovereign bond purchases to reach its goal.

“There has been some misunderstanding about the TLTROs because it has been conceived as a major failure,” Visco said. “The second tranche is more important than the first. What we have observed in a number of countries is that banks postponed borrowing until December. As far as the Italian banks are concerned, it was exactly what we expected.”

UniCredit SpA (UCG), Italy’s biggest lender, said it raised 7.8 billion euros, while Intesa Sanpaolo SpA (ISP), the second largest, took 4 billion euros.

ECB Vice President Vitor Constancio told Bloomberg News Sept. 18 that the targeted longer-term loans will lead the balance-sheet expansion. Total take-up will be “significant,” with purchases of ABS and covered bonds making a smaller contribution, he said.

Dismal Inflation

ECB President Mario Draghi has committed to increase the central bank's balance sheet toward 3 trillion euros, the size reached at the height of the sovereign debt crisis in 2012. To reach that goal, "you may need perhaps to do more if inflation remains at this very dismal level," Visco said.

Euro-area consumer prices rose 0.4 percent from a year earlier in August, compared with the ECB's goal of just under 2 percent. The Frankfurt-based central bank lowered its 2014 inflation forecast to 0.6 percent this month and said the rate would average 1.1 percent in 2015 and 1.4 percent in 2016.

ECB Executive Board member Benoit Coeure said policy makers will take their time to assess the impact of stimulus measures announced in the past three months.

"Anything we do is geared to achieving that inflation comes back to 2 percent over the medium term," he said. "In case it would not be enough, the Governing Council is ready to do more. But it's way too early to tell."

Excessive Disinflation

Visco said that the euro area is "not in a deflation mode."

"We are in excessive disinflation, and it is not an issue of a single country, it is broad-based," he said.

The 18-nation economy unexpectedly stagnated in the second quarter as its three biggest members failed to grow, triggering calls from its G-20 peers to prop up growth.

Finance ministers and central bankers from the world's leading industrialized and emerging economies said in their communique yesterday that global growth is uneven and is below the pace needed to generate jobs. G-20 economies committed in February to boost gross domestic product by an additional 2 percent over five years.

While "encouragement for the euro area comes from industrial production," output has been "disappointing" in Italy, Visco said. "Investment needs confidence and certainty. There's uncertainty about a number of areas including reforms. It's not clear whether these reforms are progressing. Overall, I think they're progressing."

Structural Reform

Italian Premier Matteo Renzi said last week that he's ready to run the risk of losing the next election to move forward with reforms. Italian Finance Minister Pier Carlo Padoan told Bloomberg News that the country is "making a lot of progress in the structural reform agenda" and should return to growth next year.

Bundesbank President Jens Weidmann told Bloomberg News that governments must take the lead in bolstering economic output, given the limited role monetary policy is able to play. He has warned repeatedly against amassing risks on the central bank's balance sheet and opposed this month's ECB's policy package.

The ECB’s ABS component includes purchases of mortgage-backed securities, an asset class whose reputation suffered during the financial crisis. Visco said it was included to increase the size of the program, given the European market for ABS market is small. The ECB’s show of confidence in the product will help reduce the stigma attached to it, he said.

The decision to buy covered bonds, assets the ECB already bought between 2009 and 2012, was also driven by concern over volumes, Visco said.

“It’s certainly credit enhancing as far as TLTROs and ABS are concerned, more quantitative as far as the covered bonds are concerned,” he said. “For the ABS, it’s clear that there’s a market failure, for the covered bonds, there’s no market failure.”