Draghi strikes again

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The ECB didn't disappoint the market and announced a raft of measures that beat expectations, which were already high. In an attempt to take full advantage of the synergies, the ECB took measures on three fronts: rate cuts, expansion of the bond purchase program and liquidity provision for banks. On this occasion, apart from the rate cut, the fresh policy action is reflected in the last two measures.

First, the asset purchases, apart from increasing the amount considerably, now include corporate debt. Starting now, the ECB will be able to buy investment grade non-financial company debt. With this move, the ECB is taking a major step into an area that implies taking on more risk. Furthermore, this decision opens a new way, apart from the banks, to jump start the real economy and, in the future, if necessary, the ECB will start to purchase other types of assets.

Second, the liquidity provision announcement is just as significant. The ECB has made available four-year liquidity operations to banks in very attractive financing conditions (cost of 0% or even negative, to -0.4% if lending registers a positive trend). Although liquidity is not currently a problem for the banks, it is true that this measures addresses concerns that sector has on two fronts: future liquidity and margins. Implicitly, the ECB is sending a clear signal: liquidity will not be a problem for the banks and, therefore, it shouldn't pose a problem for financing the economy. The measure calms markets during a time of major uncertainty and right when banks face massive maturities. On the other hand, in an increasingly adverse environment for banks, threatened by the impact of a negative interest rate environment on its margins, the option of obtaining funding at zero or negative interest rates with long terms helps mitigate said effect.

All said, the ECB has wanted to put a new twist on its strategy at a time when the role of Central Banks is in the spotlight. Although no one questioned whether the measures adopted by the ECB in the last few years were necessary, over time and in light of the economy's continued fragility, some are starting to question the ECB's ability to turn the situation around. In particular, it is the feared "markets" that question the effectiveness of the ECB's policies. And that is particularly important, because expectations are the main lever used by Central Banks. Without confidence, the effectiveness of the measures will be severely hindered. Fully aware of the risks this entails, Draghi tells those who doubt him that the ECB still has a lot of firepower at its disposal and it is prepared to use it.

Although he didn't mention which options explicitly, clearly the Central Bank is increasingly more inclined, and rightly so, to use unconventional measures (buying riskier assets, for example) instead of reducing interest rates further. I think this is a good move due to the potential adverse effects that this measure could generate both internally and externally. Interestingly, when Draghi was asked about the nuclear option of using "helicopter money", he didn't totally dismiss the idea, although, as expected, he alleged legal reasons for not discussing the matter.

Finally, as a last resort, the doubts about the effectiveness of these measures are not so easy to dispel and this shows just how delicate the situation is. This last point is clearly highlighted by the fact that the downward revision of growth and inflation forecast (1.6% and 1%, respectively, on average for the next few years) as well as the persistent negative bias concerning, especially, external risks. Not to mention the transitory effect that the announcements had on the markets yesterday: after rising ly, stock markets headed south (again due to oil), debt yields ended higher, after falling sharply and the euro ended up appreciating against the dollar. Apart from this market volatility, there is an underlying reflection: Central Banks may have more ammunition, but it is increasingly obvious that the political gains are diminishing and that monetary policy has been maimed.