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ECB makes a bold move to boost growth

New measures, including a shift away from negative interest rates, should be positive for riskier European assets

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Robert B. Waldner, Jr.
Chief Strategist and Head
Multi-Sector

New monetary stimulus measures announced today by the European Central Bank (ECB) represent a bold move, in our view, and should be positive for riskier European assets, such as credit assets. The ECB announced a number of new measures to help boost struggling eurozone growth and push inflation closer to the bank's 2% target over the medium term (about a two-year timeframe):

Measures announced:

- 10 basis point cut in the ECB deposit rate to -0.40%
- 5 basis point cut in the bank refinance rate to 0.00%
- Two new Long-Term Refinancing Operations (LTROs) with four-year maturities that allow banks to borrow up to 30% of their loan books. Banks will be charged an interest rate of 0%, which can be reduced to -0.40% if banks increase lending to the real economy. The ECB is taking care that bank profit margins are not harmed.
- Quantitative easing (QE) program increased to 80 billion euros per month from 60 billion euros.
- Non-financial corporates will be included in the ECB's QE operation – including European companies issuing debt in euros.
- The ECB provided strong forward guidance saying that its deposit rates will stay very low beyond the end of its QE purchase program and could go lower.

Invesco Fixed Income's view

These are positive measures, in our view, and represent a shift away from dependence on negative interest rates, which could threaten bank profitability, toward measures designed to encourage bank lending to the private sector, which is essential for boosting economic growth. Key pillars of these unconventional measures include more long-term financing to banks at attractive interest rates (the LTRO program) – with incentives attached to encourage banks to lend the new funds – and increased bond purchases in the open market, or QE. Perhaps the biggest – and most positive – surprise, in our view, was the ECB's decision to include corporate bonds in its monthly QE purchases.

Invesco Fixed Income believes the biggest impact the ECB could have had today was to give investors the confidence to move up the risk spectrum and hold their hand while doing so, given recent global market volatility. This is exactly what the ECB has done today by announcing that it will buy credit assets. This is important because it encourages a shift in investment appetite away from safe havens, such as government securities (German bunds, for example), toward riskier assets such as corporate bonds. Greater demand for riskier corporate assets helps lower financing costs for firms, which could potentially boost investment and ultimately economic growth.

Another main takeaway, in our view, is that the ECB has taken deliberate care not to damage sentiment toward the banks that could have resulted from deeply negative rates. Instead, the ECB has offered the banks longer-term funding certainty in a volatile environment.

In terms of the impact on the euro, we believe today's measures suggest that the ECB has shifted away from competitive devaluation of the euro, which would have been promoted by more negative interest rates. The central bank appears to have shifted toward credit easing, which may successfully bolster the transmission mechanism from ECB policy decisions to the real economy. In our view, this is a message from ECB President Mario Draghi to the bond markets that it's OK for investors to put European risk assets on their radar.

Important Information

A basis point is one hundredth of a percentage point.