

Surprise announcement from the ECB underlines concerns about economic recovery in the Eurozone

As the European Central Bank cuts rates and announces two further stimulus programs, David Hussey, Head of European and EAFE equities for Manulife Asset Management, assesses the implications for the Eurozone.

Markets were caught off-guard on Thursday, 4 September, when the European Central Bank (ECB) unexpectedly cut interest rates and announced it would be buying asset-backed securities (ABS) and covered bonds issued by Eurozone banks.

The ECB's intention regarding ABS had been previously signalled. However, the inclusion of covered bonds in the program and the coupling of this measure with a further trimming of interest rates were more of a surprise. Clearly, the central bank remains concerned about the impact of a prolonged period of very low inflation on the region's fragile economic recovery.

Indeed, the fragility of that recovery has been evident in recent economic data. The latest inflation numbers and disappointing growth data across the Eurozone has forced the ECB to act to deflect deflation.

Today's announcement seems to reaffirm ECB president Draghi's commitment to doing everything he can to support economic recovery, given the monetary tools at his disposal. The already-announced targeted Long Term Refinancing Operation (tLTRO) plus today's surprise cut in short-term rates and the promise, albeit without details, to purchase ABSs in secondary markets are an attempt to provide European banks with cheaper funding. The hope is that this funding will filter into the real economy to stimulate lending and growth.

However, Mr. Draghi also alluded to the need for tax cuts from governments and as yet, there are few signs from the Eurozone countries that they are ready to do this. Used alongside Quantitative Easing (QE), targeted tax cuts funded by budget savings would potentially boost consumption whilst helping to keep government borrowing costs low.

The ECB is doing what it can, but European economies need demand stimulus, less austerity and growth. We believe today's announcement is a step in the right direction, but more stimulus may be required to manufacture the elusive recovery. Over to the politicians...

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