theguardian

Search

ECB launches bold measures including negative interest rate to boost eurozone

European Central Bank cuts deposit rate to -0.1%, with chief Mario Draghi also unveiling €400bn of cheap funding

Angela Monaghan and **Phillip Inman**
The Guardian, Thursday 5 June 2014 20.13 BST

The European Central Bank unveiled an unprecedented package of measures on Thursday in a dramatic attempt to inject life into the eurozone's flagging economy and ward off a damaging deflationary spiral.

In a historic first for the troubled region, the ECB boss, Mario Draghi, and his colleagues on the governing council cut the deposit rate for the region's commercial banks to -0.1% from zero.

The central bank also cut its main interest rate to a new record low of 0.15% from 0.25%, and announced a €400bn (£325bn) package of cheap funding for banks on the condition it is used to lend money to companies outside the financial sector, and not for mortgages.

Draghi has come under intense pressure over recent months to make cheaper credit available to households and businesses to boost growth in the 18-member currency zone.

In the last quarter, GDP growth stumbled to just 0.2% and only avoided contraction thanks to a strong performance by the German economy.

The ECB stopped short of pumping funds directly into the financial system via a programme of quantitative easing (QE), but Draghi said the bank would "intensify preparatory work" should it prove necessary, and left the door open to further stimulus if needed.

"We think this is a significant package. Are we finished here? The answer is no.

"If required, we will act swiftly with further monetary policy easing. The governing council is unanimous in its commitment to using also unconventional instruments within its mandate should it become necessary to further address risks of too prolonged a period of low inflation."

The decision to impose a negative deposit rate on banks was described as a "bold and unusual move" by Howard Archer, chief European and UK economist at IHS Global Insight.

Trevor Greetham, a director at Fidelity Worldwide Investment, said: "Draghi handsomely beat expectations by adopting all of the measures under discussion and leaving the door open to future QE by way of asset purchases if they need to boost growth further or turn sentiment around in a crisis situation."

Action was widely predicted by analysts and markets amid a mounting threat that persistently low inflation in the 18-nation eurozone could lead to outright deflation. But it was unclear what form it would take.

Data published by the EU's statistics office revealed an unexpected fall in the annual rate of eurozone inflation to 0.5% in May from 0.7% in April, which appeared to seal the deal for more ECB stimulus.

With a lack of inflationary pressure amid a weak economic recovery, the fear is the eurozone will slide into a destructive deflation trap, where consumers and businesses delay spending in anticipation of lower prices in the future.

The ECB also lowered its eurozone inflation forecasts to 2016. Draghi said the annual rate was expected to stay at low levels in the coming months and would only rise gradually through 2015 and 2016. Inflation is expected to reach 1.5% by the final quarter of 2016. However, he played down the threat of deflation. "We don't see deflation, a self-fulfilling negative spiral."

The euro fell as investors digested the ECB's gloomier forecasts and the sweeping cuts in borrowing rates. But the Paris Cac and Frankfurt Dax benefited from the prospect of higher growth in the eurozone as a result of the policy shift. The Cac jumped 42 points to 4,543 and the Dax increased by 7.4 points to 9,943.

But some economists said the measures would prove to be too little, too late.

Marc Ostwald, an economist at Monument Securities said: "In theory, this should help, but as has been obvious in the UK, where borrowing by small and medium-sized enterprises (SMEs) is still quite weak and SME deposits are high, SMEs' distrust of the financial sector post the credit crisis remains very high."

Draghi said the purpose of the June policy meeting was threefold: to ease monetary policy; enhance the impact of measures on the real economy; and reaffirm a willingness to use unconventional measures if further easing is needed.

Draghi said the decision on the package was unanimous among the 24-strong governing council, which includes the governors of the national central banks of the 18 eurozone countries, signalling "an extraordinarily unusual degree of consensus". This indicated that Germany's Bundesbank – once unconvinced of the use of such measures – had backed the latest plan.

The Bank of England, which has already cut borrowing rates for banks and pumped £375bn of QE into the UK economy, announced at the end of its monthly meeting that it would maintain interest rates at 0.5% and the same level of QE.

More from the What's this? **More from around** What's this?