Shadow ECB Council calls ECB's package step in the right direction

At the meeting of the Shadow ECB Council on 26 June, 2014, there was a strong consensus that the measures decided by the ECB Governing Council in early June against the credit crunch and below target inflation were going in the right direction, but only modestly effective and insufficient. Almost all members believed that additional measure were needed now or in the near future. The Targeted Long Term Refinancing Operations (TLTRO) were almost unanimously considered the most important part of the package, even though many members considered the targeting rather ineffective. As additional measures, members suggested various forms of helicopter money, purchases of public bonds and purchases of asset backed securities or foreign assets.

Inflation forecast lowered, despite ECB's new measures

All members who provide forecasts continue to expect sub-target inflation for the next two years. Compared to three months ago, the average forecast for inflation this year declined from 1.0 to 0.8 per cent and for 2105 from 1.2 to 1.1 percent. The Shadow Council's mean forecast for GDP-growth remained unchanged at 1.0 per cent this year and increased slightly to 1.4 per cent for 2015. Regarding inflation, these average forecasts are in line with the latest ECB projections published in early June, while the growth forecast of the Shadow Council is 0.3 percentage points below the ECB's projection.

Shadow Council macroeconomic forecasts
(Forecast means in %, previous forecasts in brackets)

	HICP-Inflation	GDP-Growth
2013	1.4	-0.4
2014	1.0 (0.8)	1.0 (1.0)
2015	1.1 (1.2)	1.4 (1.3)

Contributors: M. Annunziata, E. Bartsch; A. Bosomworth; S. Broyer; J. Cailloux; J. Callow; E. Chaney, M. Diron, J. Krämer, F. Lindner, E. Nielsen,.

ECB's new measures considered a step in the right direction

Members were asked to rate the likely impact of the individual measures decided by the ECB Governing Council and of the package overall on a scale from 1 (none or low) through 2 (some) to 3 (high). 14 members participated. Overall they expect an intermediate to low impact of the package on economic and financial conditions in the euro area. The ending of sterilization of the liquidity impact of former bond purchases of the ECB is considered a symbolic measure. Also the lowering of the deposit facility rate into slightly negative territory and of the main refinancing rate to 0.15 percent are considered to be of more symbolic than practical relevance. There was a consensus that the Targeted

Long Term Refinancing Operations are the most relevant of the measures. However, even this measure only received an intermediate average impact score of 2.0. The extension of the earlier easing of eligibility criteria for collateral and the preparation of ABS purchases received an impact rating between low and intermediate.

Members were also asked to state their support or rejection of the individual measures and the package overall. All individual measures and the package as a whole received majority support. However support, as measured by the number of supporters minus the number of opponents, was weakest for the rate cuts and preparation of ABS purchases and highest for the TLTRO, the extension of collateral easing and the package as a whole.

	Impact Rating	**Supporters minus opponents**
Negative Deposit Facility Rate	1.3	5
Lowering Refinancing Rate to 0.15%	1.3	6
TLTRO	2	10
Temporal extension of collateral easing	1.5	10
Prpearing purchases of ABS	1.6	4
Ending sterilization of SMP purchases	1.2	8
Overall	**1.8**	**10**

Assessment of negative Deposit Rate and cut in the Main Refinancing Rate

On the positive side, members expect a potential slight improvement in the funding situation of banks in peripheral countries on the money market. Most members, however, judged, that the moderate cut in the two rates of 15 and 10 basis points, respectively, did not allow for much optimism regarding the impact. Several members would have preferred a large cut and one member criticised that the ECB combined the cut with signalling that “this was it”. On the other hand, two members disapproved of the cuts on the grounds that rates were already too low and that, while further cuts would not help the economy, they would either hurt sentiment of savers or increase the risk of asset bubbles.

Assessment of the TLTRO

While the “Targeting”-part of the Targeted Long Term Refinancing Operations was met with a considerable amount of scepticism, most members still regard this measure a fairly important one and the one with the strongest impact in the ECB’s package of early June. Many members think, it will contribute to reducing the speed of decline of outstanding bank credit in peripheral Europe. It was also mentioned that it will improve the profit situation of troubled banks, which would indirectly help the economy. Some members criticised that the measure amounted to a veiled support for the purchase of government bonds of peripheral countries. Members noted that banks could get two-year funding without any conditions regarding lending policy attached and four-year funding with fairly weak conditionality.

Assessment of preparation of ABS purchases

The announcement by the ECB to prepare for possible purchases of asset backed securities was welcomed by those members who consider quantitative easing necessary and either do not place too much importance on the choice of asset or who oppose purchases of government securities. The measure was one of the more contested ones on the Shadow Council. Several members criticised that the market for ABS was small and that there was no good reason not to intervene on the much larger government bond market and to ease dysfunctional tensions on this market. They also took issue with the implication that banks would be incentivised to sell-off their credit assets, which might weaken incentives to strive for high credit quality.

Assessment of the package as a whole and of possible extensions

Most members considered the package a welcome but (probably) insufficient step in the right direction. Most members would like to see additional measures taken, but there was no majority for any individual measure.

An equal number of members (four) suggested purchases of public sector bonds (including debt of the European Stability Mechanism) and various forms of helicopter money, respectively. The variants of helicopter money suggested, varied from the ECB sending cheques to all citizens of euro area countries to the ECB sending cheques to companies creating jobs or to parents of newly born children. Three members suggested, respectively, purchases of foreign securities and of Asset Backed Securities and stronger forward guidance regarding the future path of ECB interest rates.

Membership Changes

Willem Buiter, Chief Economist of Citigroup and former member of the Monetary Policy Committee of the Bank of England, re-joined the Shadow ECB Council, of which he had been a founding member from 2002 to 2008.

Fabian Lindner, Department Head, Economic Policy of the Macroeconomic Policy Institute (IMK) in Düsseldorf, a trade-union related think-tank, also joined the Shadow ECB Council.

Manuel Balmaseda, Chief Economist of CEMEX, and Jean-Michel Six, Chief Economist of Standard & Poor's, left the Shadow Council.

Frankfurt, 27 June, 2014
Norbert Häring (Non-voting Chairman)

Background information

The ECB Shadow Council was founded in 2002 upon an initiative of Handelsblatt, the German business and financial daily. It is an unofficial panel, independent of the ECB/Eurosystem, and comprising fifteen prominent European economists drawn from academia, financial institutions, consultancies, companies and research institutes.

Current Members:

José Alzola	The Observatory Group
Marco Annunziata	General Electric
Elga Bartsch	Morgan Stanley
Andrew Bosomworth	Pimco
Sylvain Broyer	Natixis
Willem Buiter	Citigroup
Jacques Cailloux	Nomura
Julian Callow	Catalyst Economics
Eric Chaney	Axa
Janet Henry	HSBC
Merijn Knibbe	Wageningen University
Jörg Krämer	Commerzbank
Fabian Lindner	IMK
Erik Nielsen	Unicredit
Richard Werner	University Southampton

The Shadow Council usually convenes by telephone conference on a quarterly basis. Its discussions are intended to formulate an opinion as to what monetary policy decision its members believe that the ECB's Governing Council ought to undertake, both at its forthcoming meeting and also on a three month horizon. Shadow Council members are encouraged to submit their own economic projections for euro area activity and inflation on a monthly basis, which constitutes the panel's forecast consensus as published each month.

The Shadow Council's discussions and recommendations differ from surveys of economists concerning the outlook for ECB interest rates because the Shadow Council recommendation expresses the majority view of its' members opinion about what the ECB should do, rather than what they forecast it to do (and hence the "normative" views as expressed by Shadow Council members on what they consider the ECB ought to do can and often do differ from what they might say they expect the ECB to do). This "normative perspective can, however, give an early indication of shifts in the balance of opinion in the expert community, as can be seen by comparing the historic recommendations of the Shadow Council against subsequent decisions undertaken by the ECB Governing Council.

Members of the Shadow Council base their recommendations on the ECB's objectives as defined under the EU Treaty, though Shadow Council members do not necessarily adopt exactly the ECB's specific interpretation of its mandate: most Shadow Council members consider that a medium term inflation objective of two percent with a symmetric tolerance band around it would be clearer, more realistic and more appropriate than the definition adopted by the Governing Council, which defines price stability as an inflation rate of "below, but close to, two percent", in the medium term.