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Economy

ECB: a critique of the critiques

Thursday 10 October 2019

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Since the financial crisis, the ECB's policy has often aroused controversy. Over time its actions have deviated from the framework within which monetary policy was habitually conducted. Negative interest rates, asset purchases and massive liquidity injections were once inconceivable. There is a legitimate debate about the appropriateness of these measures and their effectiveness. This debate has recently taken an unusually abrasive turn, sometimes verging on insults. We will examine here 12 critiques of the ECB to assess if they are fair, appropriate, consistent and if they offer superior alternatives to the ECB's current policy.

12 critiques of the ECB on the test bed

What is the purpose of monetary policy? How should it be conducted? These are old questions. One of the most influential schools of economic thought in the second half of the 20th Century – monetarism – gained traction by examining this problem in the case of the US, with a particular focus on the Great Depression of the 1930s[1]. For at least the past 50 years, these two questions have regularly been revisited, especially during major upheavals. They were asked before and after the creation of the European Monetary Union in 1999 and, ten years later, during the financial crisis and the Great Recession associated with it. **In other words, there is no single, unvarying and unconditional answer to these questions, unless one talks in broad generalities. In this regard, it can be said uncontroversially that monetary policy serves to reduce cyclical fluctuations and should be conducted in accordance with the central bank's mandate. This is where the debate begins.**

Recently, this debate has taken an unprecedently abrasive turn in the Eurozone. In response to the latest monetary policy package, the ECB and its president have been accused of practically every crime in the book in blunt and sometimes insulting terms[2]. These criticisms have emanated from diverse sources in political, journalistic, academic or financial circles and, last but not least, in the central banking community itself[3]. **In this note, we have identified the principal critiques levelled at the ECB and offered our own critical assessment of them.**

1) The ECB fulfils its mandate and has no reason to ease more

The ECB's mandate, set out in the Maastricht Treaty, is to ensure price stability. All central banks have the same mandate, but some, such as the Fed, have other objectives of equal importance (maximum employment). In the European Treaty, the other objectives, which are given only secondary importance, are to deliver growth and full employment. At its creation, the ECB defined price stability as inflation of below 2%. In 2003, this definition was changed to inflation of below, but close to, 2%. It would have been simpler to say 1.9%. It is common practice throughout most of the world to have a symmetric inflation target of 2%.

Of course, no-one has ever demanded that this target should be hit all the time. There are frequent deviations from the inflation target that central banks are not expected to react to, especially if this is due to temporary shocks, such as oil price fluctuations. But this is not the situation today in the Eurozone. The deviations are recurring. During Draghi's term, inflation has moved within a range well below its target, closer to 1% than

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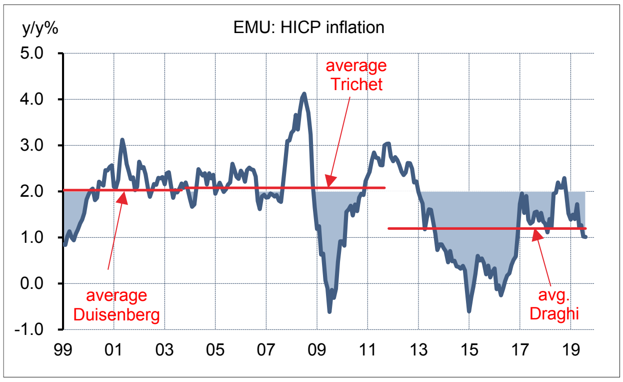
[1] *One of the most influential works is:* "A Monetary History of the United States, 1867-1960" *by Milton Friedman and Anna Schwartz, published in 1963.*
[2] *We are thinking here of an article in Bild, the German tabloid, dated 13 September, depicting Mario Draghi in the form of a vampire qui* "sucks our bank accounts dry" *(*"So saugt GRAF DRAGHILA unsere Konten leer"*).*
[3] *Among existing governors, public criticisms have come from J.Weidmann (Germany), K.Knot (Netherlands), R.Holzmann (Austria) and two Board members, S.Lautenschläger and Y.Mersch. A group of former central bankers has recently published a* "Memorandum on ECB monetary policy" *that is a full-on assault on the ECB. The signatories are a former president of the Buba (H.Schlesinger), two former ECB chief economists (O.Issing and J.Stark), the former governors of the Dutch and Austrian central banks and a deputy governor of the Bank of France. The former governor of the Bank of France and managing director of the IMF, Jacques de Larosière, has also lent his support to this text.*

2% on average (chart). To a lesser degree, other central banks in the world, for instance the Fed, have the same problem of overly weak inflation.



Our assessment. The argument that consists in saying that the ECB is fulfilling its inflation mandate is totally undermined by the evidence. A serious dose of bad faith is required to claim that an inflation rate of 1% meets the ECB's definition of price stability. But this is the Memorandum's *first line of attack against the ECB (note 3, p.1). The current governor of the Austrian central bank has even been heard to suggest that the target should be lowered from 2% to 1%, which would solve the problem. But in this case, why not target zero? It is hard to imagine a more dangerous proposal. This would be the surest way to de-anchor inflation expectations and increase deflation risk suddenly. The signatories of the Memorandum are not idiots. Their objective therefore lies elsewhere. It is to prevent the ECB from adjusting its strategy to compensate for the long period of inflation below 2% with an inflation rate of above 2% in the future. But if the ECB were to follow a so-called inflation makeup strategy, it would provide a very powerful argument to maintain the existing monetary policy stance, as heterodox as it might be.*

2) The ECB needs to keep its "powder dry" ahead of the next recession

After the financial crisis of 2008, monetary policy was loosened everywhere to an often unprecedented degree. No central bank has since restored its firepower, the ECB less than many others. It clearly has limited means to loosen monetary conditions further.

But does this mean the ECB has reached the limits? It would be rash to make such a claim. Central banks have expanded their intervention arsenal. The standard tool, which consisted in setting the price of overnight liquidity, has been combined with long-term refinancing operations, massive securities purchases programmes and strengthened communication. These tools were once non-conventional but are no longer so today. Many other forms of loosening are conceivable[4]. Central bankers[5] no less eminent than the authors of the *Memorandum* have even proposed that, in the next crisis, central banks should finance the economy directly ("*going direct*") at the price of unprecedented coordination with fiscal authorities. In short, it will still be possible to find more "powder" when and if necessary.

Our assessment. Two aspects of this argument are open to criticism. Firs, it consists in saying that monetary policy is only effective at the moment when the monetary setting is modified (through a rate cut or an asset purchase). But its effect should also be considered over time. For example, it is accepted that the stock effect of asset purchase programmes compresses term premiums, even if no more new asset purchases are made (flow effect). The central bank's credibility is far more important than the number of rounds it can still fire. Second, this argument ignores the fact that a stabilisation policy is more effective and less costly if it is implemented in a preventative manner. It was precisely because there was a risk of deflation in 2014 that the ECB had to act quickly. It is easy to say in hindsight that deflation risk would have been averted without setting negative interest rates (2014) or launching the QE on government bonds (2015). Today, the risk is of seeing the Eurozone fall into stagnation or recession. It is better to take stabilisation measures immediately. (Whether the monetary tool is more appropriate here than the fiscal tool is another question, but it is worth noting that many of the critics of the ECB's actions also reject fiscal stimulus).

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[4] *We drew up of list of these in our* Eco Flash of *30 November 2015 : "25 ways to loosen the ECB's policy"*
[5] *See Bartsch, Boivin, Fischer & Hildebrand (2019), "Dealing with the next downturn: From unconventional monetary policy to unprecedented policy coordination", BlackRock Investment Institute*

3) Monetary policy is ineffective and does not boost growth

This is the central point in the debate surrounding the ECB. It is obviously absurd to pursue a policy that has no positive impact on activity, especially if it has perverse effects on the financial sector. But it is one thing to assert as a point of principle that monetary policy is ineffective; proving it is quite another. And it is a third and separate thing to say what should take its place.

The criticism of unconventional monetary tools, especially asset purchases, has its advocates in academic research. One of the most celebrated economists in monetary theory, Michael Woodford, has frequently advocated this point[6]. At Jackson Hole in 2012, he noted that long-term interest rates are solely determined by the preferences of economic agents. No securities purchases by the central bank can modify them. If QE has effects, these only occur indirectly through a strengthening of forward guidance. It is the credibility of the central bank expressed in the forward guidance that truly modifies financial conditions, not asset purchases. Other authors argue that the effectiveness of QE stems from the fact that it boosts liquidity and acts in this way as a financial stability factor[7]. Several authors have identified that QE has indeed pushed down interest rates. In the ECB's case, several studies have demonstrated that, without the measures taken since 2014, GDP growth would have been 0.7-0.8pts lower and inflation 0.4pts lower than they were in 2017-2018[8]. Anyone who considers this to be a *pro domo* argument (i.e. a biased one) should look at the most exhaustive review of unconventional policies published recently under the aegis of the BIS, which usually stands on the side of monetary orthodoxy[9]. These studies acknowledge both the stimulating effects of unconventional policies and the efforts made by central banks to mitigate their undesirable consequences.

Our assessment. There is no consensus about the disqualification of unconventional monetary tools, either at the theoretical or practical levels, contrary to what many critics claim by omitting to cite serious studies in arguing their case. The most recent and comprehensive assessments note that these policies have negative side effects, but the positive direct effects predominate. It can easily be acknowledged that in the Eurozone, where interest rates are in negative territory and bank liquidity is over-abundant, monetary loosening has diminishing marginal effects. But this shifts the debate to how easing measures should be calibrated, not to whether they are justified or not. Implicitly, and in some cases explicitly, critics of the effectiveness of the ECB's policy are in reality proposing to tighten monetary conditions. It is hard to see how any of the problems facing the Eurozone – weak growth, low inflation or weak bank profitability – would be resolved by this in the slightest. If the policy mix is poorly calibrated in Europe, which is hard to deny, it is because macroeconomic stabilisation is too reliant on by the ECB and not sufficiently on fiscal policy.

4) The ECB is creating asset bubbles and sowing the seeds of the next crash

If the discount rate is zero, any asset generating positive cash flow should see its price tend towards infinity. This is true in theory on condition that the zero rate is a permanent regime. In practice, we have not seen asset prices follow an explosive trajectory when interest rates have fallen to zero or below zero. But the fact remains that interest rate cuts push market valuations upwards. This is one of the transmission channels of monetary policy to the real economy.

Amid memories of the 2008 crisis, any price increase tends to be interpreted as the onset of a bubble, but this term is only appropriate if prices deviate from fundamental valuations, i.e. when investors hope to be cleverer than their neighbour and exit an overvalued market on time ("*greater fool theory*"). Lastly, keep in mind that many bubbles throughout history have been formed when monetary policy was being tightened. The most famous case is that of the Fed in 1928. It is not self-evident that the ECB's monetary policy creates a risk of financial destabilisation. In reality, it reduces this risk if it lowers the probability of a recession or deflation.

How overvalued are asset prices in reality? Consider three cases: equities, bonds and property. Some stockmarkets appear expensive relative to cycle averages, but there are no signs of any generalized bubbles forming. In the case of government bonds, the term "bubble" is itself risky. Yields, as atypical as they are, can be explained by rational factors that relate, besides monetary policy, to activity and inflation conditions, global savings and investment balances and even regulations. This leaves the case of the housing market. According to Eurostat, residential property prices have risen by an

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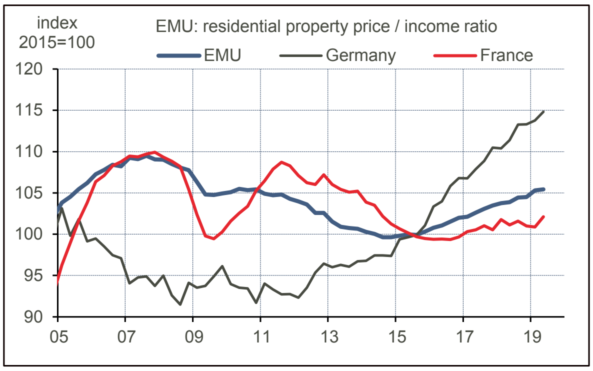
[6] *Woodford (2012), "Methods of Policy Accommodation at the Interest-Rate Lower Bound"*
[7] *Greenwood, Hanson & Stein (2016), "The Federal Reserve's Balance Sheet as a Financial-Stability Tool"*
[8] *Lane (2019), "Monetary Policy and Below-Target Inflation"*
[9] *Lowe (2019), "Unconventional monetary policy tolls: a cross-country analysis", Loh (2019), "Large central bank balance sheets and market functioning"*

average of 4% annually over the past four years in the Eurozone, and by 6.3% annually in Germany over the same period. As a ratio of household disposable income, property price increases appear far from frothy (chart).



Our assessment. Monetary policy affects the entire range of interest rates and, subsequently, all asset prices. In an environment of negative interest rates, the hierarchy of yields has been so distorted that it encourages investors to take on more risk ("search for yield") or more debt. To prevent this phenomenon from becoming disproportionate, it is the responsibility of institutions monitoring these risks to sound alerts. In the case of property, the ESRB has advised several European countries, including the Netherlands, to introduce safeguard measures to limit mortgage debt, and other countries, including Germany and France, to monitor property risk more closely. The risk of bubbles cannot be used as an argument to compel the ECB to exit its accommodative policy. This would be suicidal. In contrast, this same argument fully justifies the more widespread usage of macro-prudential tools (counter-cyclical capital buffers for instance).

5) The ECB is increasing inequalities and sowing the seeds of a social crisis

Monetary policy creates transfers between economic agents, such as between savers and borrowers. This has always been so, but in the past these redistributive effects were barely visible. The zero interest-rate threshold is unquestionably a strong psychological limit that sheds light on "winners" and "lowers". The winners are claimed to be holders of real assets (property and stocks) whose value rises and borrowers who can finance their spending with credit. The losers are claimed to be small savers whose hard-earned fortunes are deposited at banks – the very bank accounts that "Count Draghila" has sucked dry in the billions. We are barely exaggerating! In short, this criticism comes close to presenting the ECB as a factor behind widening social inequalities. It is only a short step from there to political territory. Wolfgang Schaüble, Germany's former finance minister, claimed one day that the ECB's policy was contributing to the rise of the populist AfD party, which has itself criticised the ECB for expropriating savers.

The fundamental question is whether savings and investment decisions are solely dictated by the level of interest rates – and nominal rates at that (which would be the sign of a monetary illusion) – or by real economic conditions. Here too, we need to look at the data. In the five years since the ECB launched its negative interest-rate policy, there are no signs that German households have cut their spending to save more. Over this period, their consumption has grown by 1.6% annually in volume. In the five years preceding the 2008 crisis, their consumption grew at only half this pace. It is true that employment conditions differed radically between these two periods.

No-one, not even at the ECB, questions the fact that the negative interest-rate policy is an abnormal situation. (Keep in mind that the objective of this note is not to justify negative interest rates). But no-one has ever claimed that monetary policy, over and above its short-term effects, can structurally modify the return on capital. This return depends on myriad factors unrelated to the ECB's actions, such as demographics, education, infrastructure and technology.

Our assessment. In the aforementioned Memorandum*, it is claimed that the redistribution of resources caused by the ECB penalises young generations unable to build up savings. But we also often hear it said that those who already have savings, i.e. old generations, are "expropriated" by the negative interest-rate policy*[10]*. It is hard to know where things stand. Is the ECB despoiling the young, the old, the rich, the poor, all at once? This argument is confused and typical of a partial equilibrium analysis. It totally*

[10] *See Bindseil & al. (2015), "Critique of accommodating central bank policies and the expropriation of the saver' – A review", ECB occasional paper*

omits the fact that during the period when that ECB expanded the traditional boundaries of monetary policy, i.e. since 2014, the Eurozone has had one of the best track records in its history in terms of job creations, not the most minor of factors behind social peace.

6) The ECB is zombifying the economy and reducing potential growth

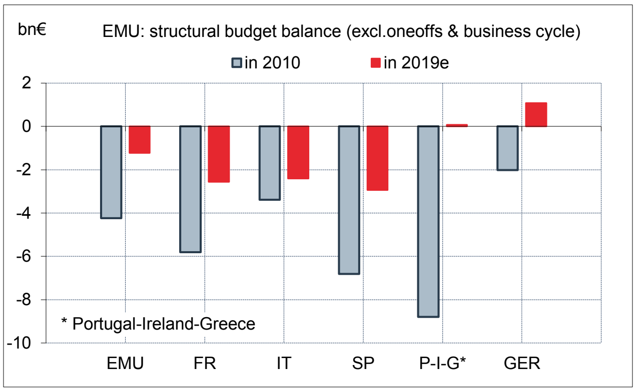
The argument is that low interest rates are keeping afloat unprofitable companies that would otherwise have gone under. Their survival allegedly prevents other firms from prospering, depressing productivity and future growth potential. Japan is often cited as an example. It would be better to "liquidate" lame ducks and to leave room for innovative companies[11].

What is the scale of the zombification phenomenon? The BIS has dedicated several papers to this question. It notes an increase in the percentage of zombie companies (defined as those that cannot cover their interest expense over the medium term with their earnings alone) in developed countries since the late 1980s. This phenomenon is not therefore radically new. The BIS pins the blame on lower financial pressure and cautiously establishes a link with falling interest rates. In these estimates[12], the BIS estimated that the share of zombie companies in 2015 was around 10% in the Eurozone…and 17% in the US, a country that has never practiced negative interest rates and has both far higher growth than the Eurozone and much lower unemployment!

Our assessment. It goes without saying that the ECB's policy benefits companies with fragile finances by aiming to loosen financial conditions. In an economy that does not use all its production potential, stricter monetary conditions would undoubtedly have the effect of driving up insolvencies (with negative consequences for creditors), but with no guarantee that this would stimulate the creation of healthy companies in a more than proportional manner. Making the zombification argument to explain weak productivity (not to mention blaming the ECB for this) is truly to miss the wood for the trees. One way to improve productivity is to invest massively in education (human capital) and technology (physical capital). Fiscal or tax incentives can be useful to achieve this goal. The ECB's highly accommodative monetary policy creates welcome fiscal space. But this still has to be used...

7) The ECB protects indebted states and, in so doing, delays their reforms

This argument comes straight out of the lowest form of conspiracy theories. In a nutshell, after falling into the hands of an Italian and, shortly, a French woman, the ECB has done all it can to loosen the fiscal constraint on overindebted states, allowing them to avoid cleaning up their public finances and making structural reforms that are often difficult to implement and unpopular.



Here too, we need to go back to the data and have at least a basic memory of events over the past ten years. Excluding Germany, the budget deficit of Eurozone countries has improved from approximately 8% of GDP at the start of 2010 to 1.5% of GDP at the start of 2019. Over this period, the cost of debt has fallen sharply thanks to lower refinancing rates. The reduction in public deficits is predominantly the fruit of structural efforts, not just the fruit of the cyclical recovery and lower interest rates (chart). In several countries, it can legitimately be argued that the fiscal adjustment imposed by bail-out programmes was too strict, thereby delaying the Eurozone's recovery. The IMF accepted its responsibility in this regard several years ago. Regarding structural reforms, as their name suggests, a long period is often necessary to evaluate all their effects, but it is untrue to say that nothing has been done, whether to the functioning of

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[11] The liquidationist theory lies at the heart of the Austrian economic school, which is fairly hostile in principle to any government intervention, including on macroeconomic stabilisation grounds. It was applied – and with what success – by President Hoover from 1929 to 1932!
[12] BIS (2017), Quarterly Review, September, and Banerjee & Hofmann (2018), "The rise of zombie firms: causes and consequences", BIS

employment markets (Spain and France) or the clean-up of banking sectors (Spain, Italy, Ireland, Portugal and Greece).

Our assessment. Far from being criticised for its direct support for banks and indirect support for sovereign states, the ECB should be credited for having completely reversed the fragmentation of credit conditions and, in so doing, eliminated the risk of a Eurozone break-up. Claims that this reveals an "intention" to favour one part of the Eurozone (the south, including France) over another (the north) are not based on any objective and persuasive evidence. We wonder what state the Northern Eurozone countries would be in today if Greece, Italy and other dominos had fallen because of the ECB's inaction…

8) The ECB is acting illegally in real, if not formal, terms by financing deficits

This is the complement of the previous point. The aforementioned *Memorandum* states that, "*from an economic point of view*", the ECB ensures the monetary financing of government deficits, which is strictly prohibited by the Maastricht Treaty. This is the same criticism that was levelled in 2010-11 when the ECB under Trichet launched the SMP (*Securities Market Program*) in opaque circumstances, in 2012 under Draghi when it created the OMT (*Outright Monetary Transaction*) – a programme never used – and then in 2015 when it began buying government bonds. At that time, however, critics were still able to claim that it was illegal. This is no longer the case.

As we know, the appeals lodged with the Karlsruhe court and the EU Court of Justice were rejected. The ECB's purchases of government securities were found to fall within the scope of monetary policy and not to contravene the Treaty. These purchases are made on the basis of criteria (quantities and ratings) that limit the risk taken by the ECB and, ultimately, European tax payers. To date, these purchases are even a source of profits for the ECB, which redistributes them to the States. There is no distortion to the benefit of the most indebted countries, as the capital key for purchases is dependent on GDP and population. Nor can it be claimed that the ECB's intervention has prevented the market from revaluing the risk of default in light of new events, as was seen in 2018 with strains on the Italian spread following elections.

Our assessment. Opponents of QE, starting with the current president of the Bundesbank, have lost the legal battle. Regardless, they can simply say that what is legally permissible is no longer economically permissible. There is something perverse about viewing the ECB as an institution whose mandate has been distorted to the benefit of indebted countries (and implicitly to the detriment of "virtuous countries"). It suggests that critics of the ECB will only be satisfied on the day that Italy has defaulted on its public debt.

9) The ECB's policy destroys the profitability of the financial sector

The current interest-rate environment is detrimental for banks in two respects. Firstly, since their traditional activity is the transformation of maturities, the flat or in some cases inverted shape of the yield curve is depressing their revenues. Secondly, their excess reserves are remunerated at the ECB's deposit rate, which means today that they are taxed at a rate of 0.5%. In 2019, this will represent a hit of around € 8bn to their pre-tax earnings. This cost is spread very unevenly between countries: 33% for the German banking sector, 26% in France, 9% in the Netherlands and 5% in Italy and Spain. Banks are caught between a rock and a hard place. There are suffering from the ECB's "negative remuneration" of their reserves but will struggle, for obvious commercial reasons, to tax retail deposits[13].

When the negative interest-rate policy (NIRP) was introduced in 2014, the deposit rate was -0.1%. The cost for banks was minimal, especially since their excess reserves amounted at the time to less than € 150bn, compared with close to € 1,800bn today. The ECB's position was to say that this "NIRP tax" was a minor side effect in view of its direct effect of loosening monetary conditions in the real economy. To defend itself from criticism, the ECB noted that the weak profitability of banks in the Eurozone mainly has structural causes relating to the fragmentation of supply (an oversized sector, with little cross-border consolidation) and a lack of rationalisation of services (digitalisation). The accumulation of new regulations is also partly to blame. Even if these arguments are valid, the fact remains that the ECB is directly denting bank earnings.

With the passing of time, the ECB has acknowledged that a negative interest rate can be reached (reversal rate) beyond which the negative effects outweigh the positive effects[14], while insisting that this level has not been attained. The ECB has recently

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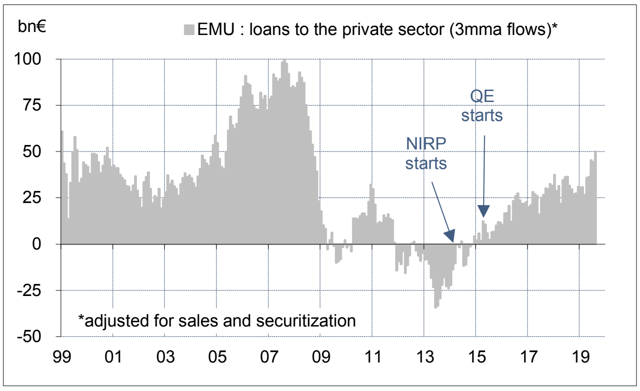
[13] *However, there are a few examples of taxation on company deposits or on individuals with large deposits (>€ 100.000).*

[14] *See Coeuré (2016), "Assessing the implications of negative interest rates", 28 July. The notion of the "reversal rate" was coined by Brunnermeier & Koby (2016): "The "Reversal Rate": effective lower bound on monetary policy", 14 March. Regarding the relationship between low interest rates and bank sector valuations, see Ampudia (2018), "Do low interest rates hurt banks' equity values?, ECB Bulletin.*

introduced a tiering system that exonerates a portion of excess reserves from taxation. The saving for banks is estimated at around € 3bn. It has also eased very long-term refinancing conditions (TLTRO-III).

For the ECB, the key question is whether the dent to bank profitability hinders the transmission of monetary policy to the real economy. Credit figures do not reveal a robust link between the strength of credit and profitability (Germany is a flagrant example of this). Generally speaking, the pace of bank lending to the private sector in the Eurozone shows no signs of weakening as monetary policy is loosened further, quite the contrary (chart).



Our assessment. The ECB has a small – fairly small – share of responsibility for the weak profitability of European banks. Its negative interest-rate policy unquestionably has perverse effects on banks, and more broadly on the financial sector. The ECB took time to acknowledge this point. It recently made efforts to contain the cost of the "NIRP tax". However, a continuation of the NIRP will encourage more and more banks to tax their depositors, with the risk of increasing resentment towards the ECB in public opinion. It would be preferable for the ECB to draw up an exit plan from the NIRP, even if this would be tricky to implement. In particular, it would need to make a credible commitment that any increase in the deposit rate is not the prelude to a more general tightening of monetary policy.

10) The ECB will one day lose control of its currency, leading to hyperinflation

This theory was all the rage a few years ago when central banks, starting with Fed, followed by the BoJ and the ECB, had massively expanded their balance sheets, either through bank refinancing operations or through asset purchases in the credit markets. How many times have we read that the famous "printing presses" were running at full steam? There were fears at the time that the explosion of the monetary base (bank reserves created by the central bank) would lead to unbridled money creation and, ultimately, an inflation spiral. This overlooked the fact that, according to quantitative theory, if inflation is *"always and everywhere a monetary phenomenon"* it is because the economy is at full employment. In a situation of underemployment, no such thing has happened.

Our assessment. There has been no inflationary spiral in any country where the central bank has massively increased bank reserves and practised a low or even negative interest-rate policy for many years. Conversely, when there has been a risk of deflation or a de-anchoring of inflation expectations, these risks have not materialised. Legitimate criticisms can be made (see point 3) about the effects of monetary policy, but concerns of a currency debasement is not one of them.

11) The ECB is pursuing a competitive devaluation policy

For once, this argument does not come from Germany (it is understandable why) but from the US, and more precisely the Oval Office. Observing that the dollar is expensive, the President views this as the outcome of a sort of conspiracy – a coincident if not coordinated one – by the Chinese and Europeans. Mario Draghi has already been honoured by a few Tweets accusing him of monetary manipulations.

Over the past 20 years, the three ECB presidents have been questioned again and again about the euro. Their response has consistently been that the euro is not in itself a monetary policy objective. The ECB has intervened, actively or verbally, in an attempt to correct a clear undervaluation (2000-2001) or overvaluation (2008-2011) of its currency. But even during these episodes, the euro was a secondary component in monetary policy decisions. There is no reason to think it will be different today. A large part of the region's exports go to other European countries whose policy is de facto aligned with that of the ECB. Eurozone exports to the US account for 3% of GDP. This would provide no scope to stimulate European growth through a devaluation.

Our assessment. In the current state of the European cycle, the euro's weakness is welcome, even if it is not actively targeted. It helps exporters, who are suffering from trade uncertainty and the slowdown in external demand. If the euro were to appreciate sharply, this would constitute a negative shock on growth and inflation, causing the ECB to deviate from its mandate. Lastly, besides short-term fluctuations, the euro exchange rate is actually relatively stable. Since 2015 (average = $ 1.13), it has only temporarily exited the €/$ 1.1-1.2 zone.

12) The ECB is mired in its current policy with no exit strategy

All leading central banks began taking heterodox measures in 2008 and the following years, including zero interest rates, negative interest rates and QE. The ECB was no exception. In most case, these decisions were taken by force of circumstance, because the alternative – doing nothing – would have had disastrous consequences for the economy and financial markets. In an emergency, there is no time to think about the long term. If history could be repeated, we think that some measures would have been taken differently. In the ECB's case, the introduction of QE was too belated (2015). An earlier implementation date would probably have allowed it to avoid the negative interest-rate policy. But there is no point revisiting the past…

Exit strategies from unconventional policies have taken time to be drawn up, in some cases through trial and error. The Fed's example is illuminating. It shows that, even with a carefully drawn-up plan communicated well in advance to the financial markets and implemented gradually, snags are possible. To our knowledge, the ECB has never formulated its exit strategy explicitly. When it halted QE in 2018 and then prepared the markets for rate hikes from 2020 onwards, the ECB reproduced a large part of the Fed's strategy. Could it stick to these initial plans when the Fed has itself modified the orientation of its policy? The answer is negative.

Our assessment. In a zero or negative interest-rate environment, the usual frontier between monetary and fiscal policy becomes porous. In the case of the Eurozone, an institutional structure with no equivalent in the world, the relationship between these two policies is abominably complicated. Some criticisms of the ECB's action are perfectly legitimate (see points 3 and 9). What is far more open to criticism, however, is the inaction of some fiscal policymakers (who are not displeased by the ECB's intervention). By leaving the ECB alone to ensure macroeconomic stabilisation, monetary policy has been exhausted and any form of normalisation has become more difficult. In short, the surest way to see the ECB restore a more normal policy is to redistribute the stabilisation role towards fiscal authorities. Rather than calling in somewhat vague terms for fiscal policy to become the principal instrument for stimulating demand, the ECB should propose the following trade-off: I will restore zero policy rates in exchange for a duly quantified European (German) fiscal stimulus.

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