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To the point!

Cross-Asset- and Strategy-Research

The ECB does not need new instruments

It should use existing instruments consistently, not develop new ones

Today, the Governing Council meets for its first regular meeting since the release of the latest inflation shock (7.5% in March for the Eurozone). With new ECB inflation forecasts not due until early June, no monetary policy action is expected, even though the March forecasts appear to have been overtaken by reality.

The ECB's hesitancy increases the risks that inflation expectations will become unmoored and price-wage spirals will be set in motion. In this case, the ECB would then have to raise interest rates all the higher. An economic recession would be the almost inevitable consequence.

Will the ECB support weaker member states directly?

In March, ECB President Lagarde announced that from the third quarter onwards the central bank would no longer add to its vast pile of government bonds. Only maturing securities already held by the Eurosystem will be reinvested.

It seems that the central bank is nervous that the risk premiums for bonds issued by governments with lower credit ratings could widen to such an extent that monetary fragmentation threatens.

If, for instance, Italian government bonds were to sell off, the ECB could reinvest the proceeds from maturing bonds in the portfolio in a targeted and overweighed manner in Italian bonds. With such an explicit deviation from the ECB's capital key, the ECB enters the borderline area of government financing prohibited by the EU Treaty.

However, that's not all. According to [media reports](#), the ECB is allegedly working behind the scenes on a new instrument that could be used to selectively buy government bonds under pressure in the capital market. Lagarde is likely to be grilled on this



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No major policy announcements expected today

The ECB wants to prevent "fragmentation" of the monetary policy impulse

new instrument as a matter of priority at today's press conference. It remains to be seen whether details will already be divulged here, or only with vague hints assuring that one is ready to do "whatever it takes".

Unnecessary and risky

Either way, the development of a new instrument is risky. A suitable instrument already exists since 2012 in the form of the OMT (Outright Monetary Transactions), even if it has never been used thus far. With the OMT, the ECB can even now make unlimited targeted purchases of government bonds of a stumbling member state. Therefore, another instrument is unnecessary.

But: OMT requires an officially supervised adjustment program to get the ailing member state's economy and finances back in order. It seems that the ECB now wants to launch an "OMT light" without economic policy conditionality.

With this, the central bank is likely to finally cross the Rubicon in the direction of sovereign financing. This would not only call into question the foundations of the European monetary union. In such a form, it would probably also have a bad hand in the constitutional courts in Karlsruhe and Luxembourg.

The ECB should refrain from such risky and unnecessary plans.

A new spread instrument could cross the line towards budgetary funding

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