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The ECB should quash expectations of further monetary policy easing

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Further monetary policy easing is more likely to have negative effects than boost the economy. Central bank asset purchases have already pushed asset prices to levels where investors are not rewarded for taking on risk. Paltry capital market rates and penalty rates on liquidity have severely weakened the banks. With savers anxious about their retirement provision, they are more likely to put more aside rather than go out on a spending spree. Under these conditions, further expansionary monetary policy measures have lost their effectiveness.

This Thursday there is no good reason to loosen the monetary reins further or signal the willingness to do so. On the contrary, the ECB should quash expectations of further easing measures and leave no doubt that it intends to sit tight. A number of factors favor this approach:

1. The economic recovery in the eurozone remains on track: negative repercussions of the Brexit vote have so far been surprisingly minor and, in the years 2015-2017, eurozone growth is set to be more or less in line with potential growth. In the first half of 2016 nominal gross domestic product, which includes eurozone inflation, was 2.8% up on a year earlier – still grounds for accommodative monetary policy but no reason to overreact.

2. The ECB's policy, especially negative interest rates on bank deposits, are evidently squeezing eurozone banks' profits and capitalization. In

addition, the central bank purchases of government and corporate bonds are artificially lowering the risk premiums essential for financial market stability.

3. Barely visible economic effects of the expansionary monetary policy on the one hand are now accompanied by extremely adverse side effects on the other. The problems caused to savers by lower interest earnings and the anxiety among many about their retirement provision are prompting them to keep their wallets tight rather than spend more. Business investment has remained relatively low despite zero interest rates, confirming that there are other reasons than borrowing costs for companies' restraint.

For the reasons set out above, stepping up expansionary monetary policy would do little to push inflation up rapidly towards the ECB's target of "below, but close to, 2 percent". Nor does the currently low level of inflation require rash action. Given currently prevailing oil and commodity prices, inflation will already be back at 1% at the end of the year, on a rising trend.

In the absence of completely unexpected events and economic setbacks, the ECB would be well advised to rein in its large asset purchases from March 2017 at the latest. The ECB should announce this now. Adequate liquidity has been sloshing around in the banking system for long enough and is by no means an obstacle to business investment. Penalty interest rates on the very high deposits of the banks at the ECB weaken all eurozone banks and should be scrapped as soon as possible. Of course there is a risk that the financial markets will react to such an announcement with disappointment initially and trigger a sell-off. But that cannot be an argument to stick with measures the impact of which is questionable and which are badly distorting prices and investment incentives on the financial markets. Monetary policy needs substantially more support from economic policy, on its own it cannot generate higher growth.

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