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The policy formula that the ECB described as “remarkable” suggests they need to ease monetary policy again

ECB's remarkable formula suggests more easing necessary

- A rule designed by former Governing Council member Athanasios Orphanides -- praised by researchers at the ECB just after the end of quantitative easing was announced -- says policy is now too tight
- The rule links changes in interest rates to the gap in inflation expectations one year ahead and the target, as well as the difference between growth forecasts and long-run potential.
- After months of weak economic data, the ECB has been forced (an euphemism to say that they were wrong in their projections) to lower its growth and inflation outlook.

Markets reaction.

- Returning to the starting point. What has all the effort in stimuli then served? German 10-year bond slips below zero for first time since 2016.
- The darkening outlook has stoked demand for German paper, with investors buying-up long-term debt amid mounting evidence of a possible recession (not our central scenario yet).

Politics does not help

- Rise of populism in Europe are fueling bets from speculators on stock market volatility, with some Hedge Funds betting on heightened political uncertainty and greater volatility in European stock markets ahead of European Parliament elections in May.
- In one of the first concrete signs in financial markets that investors are bracing for political instability, VSTOXX futures (implied volatility for futures contracts expiring in May) showed a pronounced jump to 16.8%, from 13.1% early in the week (see the chart).
- To make things even more difficult (though deep down I think it's an excellent initiative) Germany is eyeing to impose sanctions for debt ceiling violators. German conservatives aim to tighten enforcement of

the EU's debt ceiling target, under which public debt can not amounts more than 60 percent of national output. (almost nobody complies with that main rule). Chancellor Merkel's Christian Democratic Union (CDU) and its CSU Bavarian sister party, pledged in the draft presented yesterday to "limit the margin of deviations in deficit procedures and create more opportunities for sanctions in Europe".

- We will have to see how the rest of countries in the Eurozone receive the initiative to reimpose (and in some cases accelerate) the austerity.

The implications

For now, the implications range from a clear structural weakness for the EUR, to the possibility that the European equity market can not keep pace with the US market. European bonds (governments and credit) can remain sustained, though we perceive excesses in their prices (fundamentally speaking).

Best regards

