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The ECB: What it Takes for a Breakthrough

di Alessandro Leipold
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The market swings following the ECB's meeting of August 2 are not all that surprising. They reflect the duality of the decisions taken, which provide reason for both satisfaction and disappointment. The satisfaction arises from the ECB's readiness to step up to the plate in renewed support of solvent countries' government securities. The disappointment stems from the protracted implementation time. It is indeed disappointing that -- months after the suspension of the previous securities purchase program -- technical work to address its weaknesses and prepare its successor remains unfinished. We thus find ourselves having to wait several weeks for the results of the three committees now charged with studying the issue. Delays have, alas, become a constant feature of European crisis management, while piles of government securities mature and need to be renewed at punitive rates.

Given the postponement of the ESM's start at the hands of the German Constitutional Court, delay was in any event already on the cards. Let us consider rather the substance of the ECB's orientation: the possible future resumption -- in a more decisive, sustained and institutionalized manner -- of its interventions on the securities markets of countries under pressure, in an amount defined by the ECB as "adequate to achieve its objectives." It is, in the words of Bank of Italy Governor Ignazio Visco, "a genuine turning point," especially when set against the ECB's July meeting, when the subject was considered so taboo as to be left off the Governing Council's agenda. ECB President Mario Draghi thus has a point when he speaks of taboos being set aside.

Some observers have nonetheless lamented that the ECB has placed some procedural signposts for the envisaged resumption of its purchases: first, that the beneficiary countries explicitly request access to the mechanism via the EFSF/ESM and, second, that the latter set its conditionality. Apart from the fact that these pickets served to disarm Bundesbank opposition, they also have a rationale of their own -- provided they are applied with sagacity and good judgment. Here lies the crux of the issue, with two related requirements. First, that countries under pressure not hesitate to request activation of the facility. And, second, that its conditionality not stand in their way. It should in other words not be prohibitive, and be consistent with the mechanism's raison d'être: the correction, in the ECB's own words, of a "severe malfunctioning in... the bond markets of euro area countries." A market distortion not ascribable to the affected countries, as recognized also by the IMF, who estimates at 200 basis points the excess of Italian and Spanish spreads over those justified by fundamentals.

The expectation that countries seeking support for their bond markets should explicitly request it is actually a prerequisite for its success. Securities purchases that were to fall from the sky, as a sort of heaven-sent manna, would not enjoy the essential ownership of the beneficiary country, remaining detached from the nation's political consciousness and that of its government. Europe's collective memory still smarts from the experience of a year ago. Then, despite substantial ECB bond purchases from mid-August onwards, the detailed recommendations contained in the Trichet-Draghi letter to to the Berlusconi government went largely unheeded. The deadline set in the letter, which called for the (many) recommended measures to be adopted promptly by executive decree and approved by Parliament by end-September 2011, passed unnoticed in Rome -- but not in other European capitals. The lack of ownership was inter alia expressed in the damaging characterization of the measures as being "Europe's demands," implicitly denying their intrinsic benefit for the country itself.

It will be important, once the mechanism is actually operational, not to procrastinate requests for access if bond spreads remain high. Otherwise, why was so much effort spent in pushing and supporting it? The repeated denials of Italy's need for help are in this regard of concern, even though PM Mario Monti has been careful to respect a golden rule of politics: "Never say never," and has not entirely ruled out the possibility. Damage is however done by those who paint any recourse to the mechanism as submission to a foreign diktat.

But, lest it be so, Europe will itself have to recognize that a mechanism that seeks to correct market excesses cannot impose a burdensome conditionality on countries that have already done much and remain solvent. The reference to "strict and effective conditionality" in the ECB's latest Monthly Bulletin is thus worrying. As outlined by the European Council last June, a renewed commitment to already issued EU recommendations, and underwritten by the countries concerned, should suffice. That is, a confirmation of commitments already made, without new obligations.

A reading of the recommendations addressed by the European Council to Italy this July shows that they are far from interventionist, thanks to how much has already been done over the past year. For the most part, they simply call for implementing already adopted decisions, adding very little beyond that. It would be unfair for European partners to attempt to increase the dose from what they have just prescribed. And it would at the same time be irresponsible on Italy's part not to readily grasp the opportunity of a potential halving of spreads. Such a result would be well worth the "pursuit of further efforts" in the areas already being tackled -- a recurrent theme of the recommendations. Especially since such a pursuit will be needed in any event.