Il Sole 24 ORE

The Last Bastion of Credibility: The ECB

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There is by now a single remaining hope, and it is called the European Central Bank. At this juncture, each and every expectation for a resolution of the euro area's protracted crisis hangs on the decisions to be taken today by the ECB's Governing Council. Rarely have analysts' views converged to such a degree: leaving aside differences as to what exactly the ECB should do, there is universal agreement that it is the only institution now in a position to give the decisive response needed to exit the crisis.

This conviction arises primarily from the unlimited firepower that characterizes a central bank – in stark contrast to the scarce resources of the EFSF and the still unavailable ones of the ESM. Equally apparent is the ECB's much greater speed of response, shown both in the securities market program and in the massive injection of bank liquidity. Here again the comparison with governmental action is unflattering to the latter: indeed, the protracted delays in aiding Greece in 2010 constitute the "original sin" of this crisis. And governments continue to persevere diabolically in the same error: not a single euro has yet been disbursed to either Spain or Cyprus (partly also due to a misplaced sense of pride of the countries concerned).

All this erodes confidence and dents the credibility of public action, which are key to the resolution of any crisis. Consider the classic path of crisis resolution. Aside from the essential contribution of domestic adjustment and reforms, past crises have also been overcome because the provision of public support to a country in difficulty acted as a catalyst, generating confidence and triggering private capital inflows – reference was often made in this respect to the "catalytic role" of the International Monetary Fund. Although further research has revealed that this role often played more in the sense of stemming potential capital outflows rather than stimulating inflows, even such a contribution remains important (think of the ongoing capital hemorrhage in Spain).

A classic example of the positive effect of public intervention is provided by the case of Brazil in 2002, when the mere announcement of an IMF credit line managed to overcome market uncertainty prior to the elections, stemming capital flight related to the prospect of a Lula victory. A highly controversial approach at the time that was, incidentally, actively supported by Timothy Geithner, then director of the IMF's policy department.

Management of the crisis by EU governments has instead been maladroit to the point that official intervention now has the opposite and perverse effect of actually increasing private sector fears, leading to a rush for the exits. Developments in Spain on the very day that support for the banking sector was announced provide a disheartening example of how even seemingly bold initiatives, instead of having a stimulative, crowding-in effect on private capital, can end up facilitating its exit.

In the face of the indecisiveness, sluggishness, and overall ineptitude of governmental crisis management, the ECB's professionalism and credibility stand out – explaining why all hopes of redemption are now lodged in Frankfurt's Eurotower. Renewed action by the ECB could thus generate the virtuous circle necessary to overcome the crisis. To this end, its intervention (and the mind goes mainly to the purchase of government securities of solvent countries such as Italy and Spain) will need to be not only determined and sustained, but also immediately operational. What is needed is immediate action, not attempts to buy time until September 12, when the German Constitutional Court will rule on the ESM. Of course, even bold action by the ECB would not exempt governments from the choices that remain to be made, on banking union and beyond, but it could at least create the conditions for their realization in a calmer setting.

Confidence in the ECB is not however unlimited. Indeed, the raising of expectations by President Mario Draghi's statements, and the focusing of attention on a single meeting seen as decisive, is a high-stakes game that could severely strain the institution's credibility. It is in fact a movie we've seen far too often during this crisis. One episode starred President Draghi himself when, last December, he seemed to set out a sequence whereby, following approval of a fiscal pact, the ECB would be ready to intensify its purchases of government securities of crisis countries. Only to block off this road at the subsequent press conference.

This time there can be no turning back, and every road must be kept open. Mario Draghi himself is certainly well aware of this, and has reportedly worked to carefully prepare the ground. It is of course essential that the ECB's Governing Council be just as aware, and that whatever action is decided is not then undermined by public dissent. As central bankers, the Council's members ought to be fully attuned to the central role of expectations in the conduct of monetary policy. They should bear in mind that this applies no less to crisis management, and act accordingly, in the decisions they will take, in their timing, and in the related communications policy.