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WORLD

Slow Growth Prods Central Banks

The European Central Bank announced new stimulus plans and the Federal Reserve signaled more reluctance to raise U.S. interest rates this year

Mario Draghi, president of the European Central Bank, right, spoke beside Luis de Guindos, the bank's vice president, during a rates decision news conference in Frankfurt on Thursday. PHOTO: JASPER JUINEN/BLOOMBERG NEWS

By Nick Timiraos, Tom Fairless and Brian Blackstone

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Concern over sluggish global growth is causing central bankers to shift tacks, as the European Central Bank unveiled surprise plans Thursday to stimulate the Continent's flagging economy and Federal Reserve officials signaled their growing reluctance to raise U.S. interest rates at all.

The ECB, acting less than three months after it phased out a €2.6 trillion ($2.9 trillion) bond-buying program, said it would hold interest rates at their current levels at least through the end of this year—months longer than it previously signaled. It also will issue a fresh batch of cheap long-term loans for banks starting in September.

Several top Fed officials, meanwhile, have stopped talking about the need to lift interest rates, a stark change from three months ago. The stance suggests more officials won't pencil in any rate increases this year after their March 19-20 meeting.

The U.S. economic outlook "appears to have softened against a backdrop of greater downside risks," said Fed governor Lael Brainard on Thursday. "Prudence counsels a period of watchful waiting." She made no mention of the need to raise interest rates, a shift from her position last year.

Investors quickly reacted to a ECB response to slowing global growth that was more aggressive than they expected.

Shares slid, with both the Stoxx Europe 600 and the Dow Jones Industrial Average falling 0.8%. The euro fell 0.4% against the dollar, as yields on Italian and German bonds declined, a sign investors are uncertain about prospects for growth and inflation.

Negative interest rates in Europe and Japan, together with historically low nominal rates in other rich nations, leave central bankers with little room to cut borrowing costs to provide stimulus if their economies fall into recession. German 10-year bond yields fell, a sign of the continued extraordinarily loose lending conditions in the eurozone.

As a result, global central bankers appear to be moving pre-emptively to shore up flagging growth before any slowdown deepens.

The Bank of Canada held on Wednesday its key interest rate steady at 1.75%, and officials expressed more caution about the outlook while revising down domestic growth forecasts. Australia's central bank likewise held its rate steady on Tuesday and warned of growing risks to the global economy.

China's government has unveiled growth-enhancing efforts, including new tax cuts and increased bank lending to small and private companies.

ECB President Mario Draghi said Thursday the likelihood of a recession is very low, but risks to the economy remain prevalent. The ECB's decision was unanimous, he said. "We never thought we were behind the curve," Mr. Draghi said, and "in any event today we are not behind the curve, for sure."

The Fed's shift reflects officials' calculation that weaker demand abroad and diminished risk-taking in financial markets could keep a lid on domestic prices. Inflation has been running slightly below the Fed's 2% target through a period in which many officials had projected prices to edge up.

Last year, Fed officials raised their benchmark rate four times in a bid to raise borrowing costs closer to a so-called neutral level that neither spurs nor slows growth.

As recently as December, officials had projected two more rate increases for 2019. Officials are set to lower projections at their meeting this month, likely showing either one or zero rate increases for the year.

The latest change suggests more officials could conclude rates aren't as far from neutral as previously thought.

The Fed's January shift to pause rates helped calm markets that turned more volatile last December, when trade tensions between the Trump administration and China flared and the federal government began a partial shutdown that lasted for 35 days, a record.

The S&P 500 slid 11% between the end of November and Jan. 3, and it has rallied 12% since Fed chairman Jerome Powell first signaled a rate pause on Jan. 4. The index is 6% below the all-time high reached last September.

The Fed is preparing to say when this year it will end the gradual runoff of its $4 trillion asset portfolio, which will leave the Fed with a much larger balance sheet than officials had anticipated when they began shrinking the holdings in 2017.

Several Fed officials, meanwhile, have set a high bar to raise rates again, particularly now that the target range for their benchmark rate is at the low end of estimates of a neutral setting.

One camp has said rates are still below neutral, and their baseline outlook has the Fed raising rates once more this year. Another camp has said it sees little need to raise interest rates so long as inflation isn't rising above the central bank's 2% target.

San Francisco Fed President Mary Daly said in an interview last month that if her current outlook of 2% growth and stable inflation is realized, "the case for interest rate increases is not there."

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Two top allies of Mr. Powell have indicated their views may align with this latter camp. In remarks last week, Fed Vice Chairman Richard Clarida said it was appropriate for the Fed to step back from a framework that had guided rate increases over the last three years.

For years, officials moved rates up based on the theory that a falling unemployment rate would eventually generate price pressures and that, even with inflation running below its 2% target, the Fed needed to act pre-emptively to contain such pressures.

Mr. Clarida said last week that Fed officials must now focus on "maximizing the odds of being right given the reality that the models that we consult are not infallible." For example, he said, if models predicted a surge in inflation from a growing imbalance of supply and demand in the economy, officials would need to weigh the benefit of pre-emptively raising rates "against the considerable cost of the model being wrong."

New York Fed President John Williams, another top lieutenant to Mr. Powell, said Wednesday he believed U.S. interest rates had nearly reached neutral and that he expected the domestic economy to grow at its 2% trend level this year. That outlook would be consistent with holding rates steady.

The ECB's moves reflect sustained weakness in several economies. In 2017, boosted by its stimulus measures—including bond buying and negative interest rates—and a surge in demand for its exports from China and elsewhere, the eurozone's economy grew at the fastest pace in a decade, outpacing the U.S. But it slowed sharply last year as those sources of support waned, growing at its weakest pace since 2014.

European officials are seeking to shore up an economy that has been rattled by shocks ranging from a slowdown in China to mass protests in France and bottlenecks in Germany's crucial auto industry.

They are treading a careful path between providing sufficient support for the region's softening economy while avoiding any appearance of panic, which could ricochet through financial markets.

Still, the ECB refrained from more extreme measures such as restarting its bond-buying program or cutting its deposit rate further from minus 0.4%. These options weren't discussed, Mr. Draghi said.

"In a dark room, you move with tiny steps," he said.

Write to Nick Timiraos at nick.timiraos@wsj.com, Tom Fairless at tom.fairless@wsj.com and Brian Blackstone at brian.blackstone@wsj.com

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