

The ECB's actions in the coming months could mark a significant – and positive - turning point in the euro crisis according to Rupert Watson, head of asset allocation at Skandia.

Commenting he said: “The European Central Bank is likely to take actions over the coming months that could mark a significant turning point in the euro crisis and further strengthen sentiment towards global stock markets.

“However, the ECB will not be able to save the euro alone if individual governments do not continue to reform their economies.

“First, the ECB could begin a program of buying short dated bonds for those countries that have officially requested support and are thus already subject to conditions and monitoring. It would probably start with Portugal as it has already requested support and would aim to bring those yields much closer to German levels.

“At least in the short run, it could commit (or imply a commitment) to purchase bonds in unlimited quantity. We view this as likely.

“Second, the ECB could expand its collateral rules for banks, making it easier for them to borrow from the ECB. We view this as highly likely.

“Third, the ECB could cut interest rates from 0.75% to 0.5%. We view this as highly likely.

“Fourth, the ECB could launch a new long term refinancing operation (LTRO). This is likely if options 1-3 fail to result a material improvement in the sovereign and banking markets.

Will it work?

“In the short run, the ECB is likely to be able to bring short dated peripheral yields much closer to Germany's level. As a central bank, the ECB is able to create the euros to buy the bonds in

unlimited quantities.

“What would perhaps be more significant than lower bond yields, however, is the signal that the ECB is likely to play a more central role in resolving the crisis. Previously, the ECB had signaled it would respond after national governments had improved their finances and made substantial reforms.

“In the long run, even a more forceful ECB will not be able to save the euro if individual governments do not continue to improve their finances and reform their economies. The fiscal reforms imply weak or negative economic growth for many years to come.

“However, while the last two years have taught us all to be skeptical of talk of progress within the eurozone, the ECB's actions could mark a significant turning point in the crisis.

“This would be a very positive development for the global economy and global financial markets.”