**European Central Bank’s Bond-Buying Plans Face Doubt**

Some Economists Say the Move Will Do Little to Stimulate Limp Economy

By BRIAN BLACKSTONE, WSJ.com, Jan. 11, 2015 5:17 p.m. ET

FRANKFURT—The European Central Bank is widely expected to follow the U.S. Federal Reserve’s lead this month with a new program of bond purchases meant to stimulate the eurozone’s limp economy.

Whether it works is another matter.

Bond-buying programs, known as quantitative easing, are meant to drive down borrowing costs to encourage households and businesses to borrow, invest and spend. They also aim to boost the value of assets such as stocks and encourage more risk-taking. In addition, they tend to push down the value of a nation’s currency, which helps to boost exports.

The currency component is especially important in Europe, where the euro has tumbled to a nine-year low against the dollar.

**Yet quantitative easing has faced serious obstacles even in places where it has scored apparent successes. Those obstacles could be even more formidable in Europe, where gross domestic product remains below 2008 levels and unemployment remains in double digits.**

The Fed, for instance, accumulated a portfolio of $1.7 trillion worth of mortgage-backed securities, but its efforts to push down mortgage rates didn’t help millions of Americans who were locked out of refinancing at lower rates or taking out new mortgages because they were burdened by bad credit and faced tighter bank standards.

Some studies of the effectiveness of quantitative easing in the U.S. have suggested it was most potent when aimed at private securities markets such as those based on mortgages, even with the impediments in those markets.

**But private debt-securities markets in Europe are too small for the ECB to tap aggressively. About 80% of corporate lending in Europe is done through the region’s financial institutions, rather than through bond markets. And the banking system is highly fragmented along national boundaries. For instance, small businesses in Germany are able to borrow at 2.8% interest, according to ECB figures, versus 4% in Spain.**

Private-market measures by the ECB so far—including cheap loans to banks and targeted purchases of private-debt securities—have provided tepid results.

The Frankfurt-based central bank aims to boost its portfolio of securities, loans and other assets by around €1 trillion ($1.18 trillion) over the next couple of years.

**To achieve large results in a bond-purchase program, the ECB has little choice but to opt for buying from a vast array of government bonds. But borrowing costs in these markets are already low, which could limit the program’s effectiveness. Germany’s 10-year bond yield is just 0.5%, and Spanish and Italian yields are under 2%, despite high debt levels in southern Europe.**

**In short, while quantitative easing might help overburdened governments, it isn’t clear the efforts will filter through to the broader European economy.** “QE is good for the finance ministries and banks in highly indebted countries, but it will not change the medium outlook for economic growth,” said Jörg Krämer, chief economist at Commerzbank .

**A related problem in Europe is that, unlike central banks in the U.S., U.K. and Japan, there is no single, federal asset to buy. Because the euro area remains a fragmented financial web, the ECB must pick through 19 different public bond markets, each with varying degrees of riskiness, from triple-A German bonds to junk-rated Greek debt. That could dilute the effectiveness of a program.**

“It’s quite different from doing QE in the U.S.,” said Harvard University professor Ken Rogoff. “It would be like Fed buying California or Illinois bonds when they’re in trouble.”

Economists cite other roadblocks that will hold back the European economy even after a program is launched. That includes the need for governments in France, Italy and other struggling economies to make politically unpopular changes to their labor markets that might encourage employers to hire. Moreover, large government debt burdens in many euro-area economies have led to restrictive tax and spending policies that are holding back growth.

**“There is some concern that QE and a cheaper euro will take pressure off to do structural reform,”** said Timothy Adams, president of the Institute for International Finance and former U.S. Treasury undersecretary for international affairs.

Yet Mr. Adams, like many other economists, believes the ECB needs to proceed after signaling action for several months. “The markets will be incredibly disappointed if it doesn’t happen,” he said.

QE also can affect human psychology and confidence. Former Fed Chairman Ben Bernanke often spoke about demonstrating resolve during the U.S. financial crisis. Bank of Japan Gov. Haruhiko Kuroda has frequently expressed determination to shake Japanese households and businesses out of a deflationary mind-set.

Some analysts are looking for similar expressions of resolve from ECB President Mario Draghi. “What I’m looking for is the message that they’re unconstrained, that they can do enough” stimulus to bring inflation back up to 2%, said RBS economist Richard Barwell. “That would give you the big bang up front.”

**This test of resolve is especially pertinent in Europe now. Consumer prices fell 0.2% on an annual basis in December, the first decline since 2009. Unlike the Federal Reserve—with its dual mandate for stable inflation and full employment—the ECB’s sole duty is to keep consumer prices stable, which the bank defines as annual inflation close to 2%.**

**The longer consumer prices stay flat or negative without a policy response, the more financial markets will question the ECB’s credibility**.

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