

ECB

ECB: 'Let's See' First, But Leaves Door Open To QE

- **ECB does not reinforce focus on balance sheet increase, but that should not be read as backtracking, in our view.** In its October meeting, the ECB kept all policy rates unchanged and the details of the ABS and covered bonds purchase programme (ABSPP and CBPP3) were largely as expected. The ECB did not provide an overall or even monthly/quarterly target size for the asset purchases, but only noted that the programme would last at least two years and, together with the TLTROs, would have a *'sizable impact on our balance sheet'*. ECB President Draghi said that the ECB would want to 'see' if already-announced measures will be effective, but in our view he kept the door open for additional easing if, as we expect, inflation continues to undershoot the ECB's forecasts and the ECB judges that the inflation undershoot is likely to persist. Draghi reiterated that *"the Governing Council is unanimous in its commitment to using additional unconventional instruments within its mandate"* and we continue to expect a QE programme, mostly focused on government bonds, to be announced in late-2014 or early 2015.
- **ABSPP and CBPP3** details highlight that the ECB will buy ABS and covered bonds that are rated at least BBB- in both primary and secondary markets. For Greek and Cypriot assets, the rating threshold does not apply as long as they are in an EU/IMF programme (as for the ECB's repo operations), and subject to additional conditions. As previously indicated, the ECB will buy senior ABS tranches, and in addition 'guaranteed' mezzanine tranches, with the eligibility criteria for the guarantees to be communicated at a later stage. Only ABS backed by non-financial private sector loans are eligible and 'fully retained' ABS only with 'some participation by other market investors', whereas fully retained covered bonds are eligible. No indication of the targeted size of the purchases was provided, but the ECB noted that the current stock of eligible assets for the ABSPP and CBPP3 was jointly around €1trn.
- **Balance sheet and inflation expectations.** Draghi stressed that the *"inflation outlook has worsened and downside risks had increased."* He added that in the recent past, inflation undershoots had been driven by high unemployment and weak aggregate demand (and not just falling commodity prices or the exchange rate). In our view, these statements suggest that the ECB is concerned that the inflation undershoot is likely to persist, which probably would trigger further easing. Draghi stressed that balance sheet size was at most an intermediate target. But he also said that he expected the announced measures to impact the ECB balance sheet *'in coming months, not years'*, even though he refused to be more precise about the expected or desired increase, other than to reiterate that the ECB expected the balance sheet to be *'steered towards its size at the beginning of 2012.'* **Monetary divergence and euro.** Draghi highlighted the increasing divergence in monetary policy between the euro area and 'other major advanced economies', which reflected economic divergence, and that the weaker euro should be seen in this context – suggesting the weaker euro will not stand in the way of further easing.

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