

Euro Area

ECB Launches QE, Removes Balance Sheet Constraint

- **QE starts in March** — The Governing Council (GC) announced that it will buy euro-denominated investment-grade bonds issued by euro area governments, agencies and EU institutions in the secondary market from March. The GC indicated that the program (including ABS & covered bonds) will be €60bn per month (about €43bn govies, €6bn supras, €11bn of covered & ABS), adding up to €1.1tn, which was on the high side of expectations. The GC currently intends to buy “*until at least end-Sep 2016*”, adding that purchases will “*in any case be conducted until we see a sustained adjustment in the path of inflation [...] consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term*”.
- **Open-ended QE?** A key point is that the previous reference to a €3tn balance sheet target has been dropped from the statement and hence reducing risks that the €3tn figure could become a constraint that limits QE. Hence the GC has, in our view, reinforced its guidance of a very loose policy stance until inflation expectations are clearly re-anchored on a “*sustained*” basis. This means that the GC will likely maintain its QE program until it is confident of being able to deliver on its price stability mandate. The ECB could also adjust the pace of purchases, and raise them when the program is reviewed, most likely around the publication of quarterly staff economic forecasts. International experience suggests that QE needs to be large and lasting to provide much stimulus to the economy. Our 2017-19 inflation forecasts, averaging 1.5%, suggest that the ECB will probably continue QE beyond Sep-16, unless the euro were to fall more quickly than we anticipate (€/\$ parity in Q2-16) and/or economic activity were to surprise to the upside. The ECB could still take the deposit rate lower if it concludes that it would help achieve the objective.
- **Strong coordination but limited risk-sharing** — Purchases will be made according to the NCB's shares in the ECB's capital and the GC will “*retain control over all the design features of the program and the ECB will coordinate the purchases*” with a view to “*ensuring the singleness of the Eurosystem's monetary policy*”. The risk-sharing will apply to debt issued by European institutions (which are targeted to represent 12% of the purchases) and to the 8% of the purchases of government bonds to be held by the ECB, adding to 20%. The remaining 80% of purchases of government debt by national central banks will be at their own risk. President Draghi indicated on a number of occasions during the Q&A that he did not think that risk-sharing decision (obtained by consensus, i.e. very large majority or very few dissenters) would limit the effectiveness of monetary policy. We largely share his view and would note that the liabilities (euros created for the QE program) are fungible. Mr. Draghi also suggested Greek debt would not be part of the asset purchase program for now, based on the 33% limit that the GC intends to enforce with respect to exposure to a sovereign issuer. Mr. Draghi also made reference to a 25% limit applying to single issues to avoid having a blocking minority in possible collective action clauses and to ensure a parri passu status.

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