26 October 2017

Financial Markets Research Team
Nick.kounis@nl.abnamro.com
Tel: +31 20 343 5616
nick.kounis@nl.abnamro.com

ECB signals prolonged monetary stimulus

The ECB's decisions and communication are consistent with a prolonged period of monetary stimulus. QE may well last through 2018, while interest rate hikes may not come until well into 2019. The announcements are in line with our base scenario. We think that the ECB's number one goal in announcing this package was to prevent a tightening in financial conditions. So far it has passed the test with honours. The market reaction was positive with bonds and equities rallying and the euro declining.

The key decisions:

1. The ECB extended its QE programme by 9-months, but halved the pace of monthly bond purchases. The programme will run through to September 2018 at a pace of EUR 30bn per month (compared to EUR 60bn up until December 2017).
2. The forward guidance on QE and interest rates were left unchanged. On QE the ECB signalled that it was ready to 'increase the APP in terms of size and/or duration'. The ECB continued to communicate that it expects 'the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases'.
3. Principal payments from maturing securities purchased under the APP will continue to be re-invested for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary.
4. The main refinancing operations and the 3-m longer-term refinancing operations will continue to be conducted as fixed rate tender procedures with full allotment at least until the end of 2019.

Key takeaways:

1. ECB President Draghi made it clear that if the ECB decides to end the QE programme in September 2018, it will not stop abruptly, there will be a taper after that. This means the QE programme could effectively last at least until the end of 2018, and possibly into Q1 2019.
2. Given the rate guidance, the likely time horizon for QE, means that policy rates may not go up until the second half of 2019. That leaves current market pricing for a 10bp hike in April 2019 looking pessimistic.
3. The ECB was not explicit about the breakdown of the APP but President Draghi said that the ECB would continue to buy a 'sizeable' amount of corporate bonds. That keeps alive the possibility that the slowdown in the APP will be more focused on public sector bonds. This is confirmed in the press statement with

additional information, which states that 'purchase volumes under the three private sector purchase programmes (the ABSPP, the CBPP3 and the CSPP) will remain sizeable'. That should be supportive for the spreads in these debt securities.

4. Despite the slowdown in the overall purchase amount and reduction in public sector bond purchases, it is likely that the ECB will continue to be a significant buyer of eligible bonds in 2018 and in 2019. Since reinvestment will be carried out for an extended period and purchases will continue, the ECB's balance sheet will grow and remain at high levels for a longer period. We estimate that reinvestments will average an amount of EUR 15 – 20bn a month. The total gross monthly purchase amount will therefore be at around EUR 50bn up to September 2018, compared to EUR 65bn currently. In addition, the ECB confirmed today that redemptions of its QE holdings will be reinvested in the same country jurisdiction. As such, we expect that German reinvestments will be significant due to the high share of Germany in the ECB's capital key and the large amount of future reinvestments of German eligible assets. As a result, net adjusted German supply (when taking into account bond supply, redemptions and QE purchases) will be extremely negative, which will mitigate upward pressure on German outright yields in 2018. (Nick Kounis, Aline Schuiling, Kim Liu)