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ECB to ease in September

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Central banks: ECB waiting for more information - The ECB kept its policy rates and target for asset purchases on hold as expected. In the press conference following the decision, ECB President Mario Draghi stressed that there was a lot of uncertainty about the outlook, but that the central bank was ready to act if needed once a clearer picture emerged. This would possibly be in September in the light of the central bank's new forecasts. The ECB's base case continues to be for 'an ongoing economic recovery and an increase in inflation rates' given that following the UK's vote to leave markets had been encouragingly 'resilient'. On the other hand, given the 'uncertainties', the ECB would monitor the situation 'very closely'. In addition, the ECB statement signalled that 'when we have more information, including new staff projections, we will be in a better position to reassess the underlying macroeconomic conditions' and 'If warranted to achieve its objective, the Governing Council will act by using all the instruments available within its mandate'. Indeed, during the Q&A Mr Draghi went out of his way to stress the ECB's 'readiness, willingness and ability to act'. However, there was no further information provided on the types of measures it would take or of any actions to increase the eligible universe of bonds for the QE programme, which were not discussed according the ECB President. Finally, in terms of Italy's banking problems, Mr Draghi seemed to put himself more on the side of the Italian government, which wants a public sector bail-out, than the European Commission and German government, that are insisting on a bail-in of the private sector. (Nick Kounis)

Central banks II: ECB expected to ease in September - We expect the ECB to step up its QE programme in September (with monthly asset purchases rising to EUR 100bn from EUR 80bn). In addition, it is likely to extend the programme to the end of next year, compared to the soft deadline of March 2017 currently. The ECB will need to also announce measures to expand the eligible universe of public sector bonds in order to meet these targets, in fact it needs to do that even to meet its existing targets. This reflects that the fall in bond yields has meant more and more government bonds have yields below the deposit rate (of -0.4%) making them ineligible. There are three major options to change the programme. First, dropping the deposit rate floor for purchases. Second, increasing the issuer or issue limit. Third, dropping the capital key weights for purchases and moving to a debt weighted-key. We think options 1 or 2 will be deployed (or some combination) rather that option 3, which would be politically more difficult. A debt key would mean that the ECB would buy more Italian and Belgian bonds, while options 1 and 2 would keep the relative amounts of bonds of different countries bought unchanged compared to the current system. (Nick Kounis)

Global FX: Focus on chances of policy easing - Since the UK's vote to leave the EU, the currency markets have been focused on the likelihood and timing of BoJ, BoE and ECB monetary policy easing. Today, the ECB left monetary policy unchanged as expected, but Draghi left the door wide open to take further measures, most likely in September. The euro was rather volatile during the press conference, with some initial disappointment that Mr Draghi was not more dovish leading to euro strength, but afterwards EUR/USD more than reversed its gains. Going forward, we expect the euro to be range-bound versus the US dollar at around 1.10. Last week, the BoE refrained from easing monetary policy, which came as a complete surprise to financial markets, but it strongly signalled that it would ease policy at the August meeting. This week two BoE officials hinted that monetary policy easing at the August meeting is not a done deal. This and resilient UK economic data have supported sterling. We think that sterling will weaken going forward as we expect UK data to start to weaken markedly and negotiations between the UK and the EU to prove to be tough. Over the recent weeks, expectations about monetary and fiscal stimulus in Japan, in a constructive investor climate, have weighed on the yen. There have even been some expectations about helicopter money arriving in Japan. We think it will be difficult for the BoJ to meet these high expectations on 29 July. Therefore, we expect the yen to strengthen going forward. (Georgette Boele)

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