CIO Flash

ECB specifies QE exit

The European Central Bank has decided on the fading out of its bond-purchase program along widely expected lines

This time around, the European Central Bank (ECB) has done a pretty good job in guiding the market ahead of today's critical meeting of the Governing Council. This was reflected in the unusually high degree of consensus of market participants' expectations and also in the fairly muted market reactions. Not bad, consider that with today's decisions, the ECB has entered a new stage in moving towards exiting its bond-purchase program has been decided. In detail, the ECB's Governing Council decided that:

- key interest rates will remain unchanged (deposit facility rate at -0.40% respectively)
- monthly net bond purchases will continue at the current pace of €60bn and be cut to €30bn per month from January 2018 onwards,
- purchases at the €30bn are intended to last at least until September 2018 – or beyond, if necessary,
- main purchasing parameters (issuer limit, country keys) will remain unchanged.

We expect net bond purchases to, at the very least, shrink further from September 2018 onwards, and to fade by the end of next year. We note, however, that the ECB kept a vague wording and left itself plenty of leeway. The way in which it did so probably contributed to the fact that market participants interpreted the decision in a slightly more dovish way than some had expected. As a result, German Bund yields and the euro ceded some ground, although their moves were not dramatic when compared to the trading ranges in recent days. The ECB stressed that rates will only increase long after net purchases have stopped. Partly, this was probably intended to avoid a further strengthening of the euro. We expect no rate hikes before 2019.

However, the ECB's decision was not quite as simple as it might appear in retrospective. Once again, the Eurozone's central bank was facing a dilemma. On the one hand, inflation figures and expectations remain low. On the other hand, the Eurozone economy has been developing better than expected. However, since the middle of June, the dollar-denominated price for a barrel of Brent oil has risen by 30%. Calculated in euros, that translates into a 22% increase, which could lead inflation to accelerate a bit. Furthermore, the euro's ascent that started in spring, ran out of steam since the start of September. That made the ECB's task a little easier.

Based on the monetary policy decisions and the ensuing press conference, we see no reason to change our forecasts in any significant way. We continue to expect yields on 10-year government bonds to rise to 0.8% by September 2018. We do not

In a nutshell

- The ECB council has broadly met market expectations, with a slight dovish bias
- Bond purchases will be cut to a monthly pace of €30bn from January 2018 onwards. The ECB intends to maintain this pace at least until September 2018 – or beyond, if necessary.
- We see no need to adjust our forecasts for euro-denominated bonds and EUR/USD

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expect the euro to start soaring again in coming months. That has less to do with the political situation in the U.S. than interest-rate differentials. The gap has more than doubled over the past two years. Two-year U.S. Treasuries currently yield 2.3% more than their German counterparts, compared to 1% two years ago.

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Glossary

Deposit rate

The deposit rate is the rate banks receive when they make overnight deposits with the ECB

European Central Bank (ECB)

The **European Central Bank (ECB)** is the central bank for the Eurozone.

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