



TD Economics

March 6, 2015

Data Release: European Central Bank announces details on QE

- At its meeting yesterday, the European Central Bank (ECB) left all policy rates unchanged – refi rate at 0.05% and deposit rate at -0.20% – as expected by the market.
- The ECB also significantly revised its economic and price forecasts. It now expects much stronger real GDP growth of 1.5% in 2015 and 1.9% in 2016 (and even 2.1% in 2017), relative to 1.0% and 1.5% in 2015-16 previously. It also revised down its inflation forecast from 0.7% Y/Y to 0.0% for 2015, but raised its 2016 forecast from 1.3% Y/Y to 1.5%. In 2017, it sees price growth averaging 1.8%, which would be on par with its target for inflation "below, but close to, 2% over the medium term".
- In the Q&A after the meeting, Mario Draghi announced that the ECB would buy bonds at negative yields up until the deposit rate, which is currently -0.20%. This suggests that should the deposit rate be lowered, the ECB could expand its purchases to even lower-yielding sovereign bonds; however, for now, the deposit rate should act as an effective floor for euro area yields. Among benchmark sovereigns, solely the German 2-year bond currently has a lower yield than this threshold, although only very marginally so.
- In technical details released afterwards, it was stated that should the amount of available securities in any jurisdiction be insufficient for the ECB's desired level of purchases as per its capital key, the ECB would substitute these with other purchases. In other words, the market should not doubt the ECB's resolve in fully purchasing €60bn of securities per month. Purchases will begin on March 9th, and are expected to last until at least September 2016. The ECB will only purchase bonds with remaining maturity between 2 and 30 years. The purchases will have no specific duration target, and will attempt to be as "market-neutral" as possible, i.e. causing as little distortion as possible.
- In the Q&A, Mario Draghi also clarified some issues with respect to Greece. Firstly, the ECB will not purchase a government's bonds while a country in a bailout program is currently under review – which Greece and Cyprus currently are. It also cannot purchase bonds below investment-grade unless a waiver is provided – this waiver was removed for Greece last month, as the ECB could no longer "assume a successful conclusion of the programme review". Finally, even if Greece successfully passes the review and the waiver is reinstated, the ECB cannot purchase more than 33% of an issuer's bonds, a limit which is already breached, and will remain so until Greece's repayments to the ECB in July-August of this year. Therefore, the earliest that the ECB could begin purchasing Greek bonds under its QE program would be near the end of the summer. This maintains pressure on Greece in its continued negotiations with the EU-ECB-IMF.
- Markets appeared satisfied with the details. The QE program should result in more euro supply, and accordingly markets weakened the euro after the meeting. The currency lost ground further against the U.S. dollar in the wake of the strong payrolls numbers on Friday.
- Overall, the tone of the announcement was particularly upbeat. TD Economics is in line with the ECB in seeing stronger growth over the next two years, but challenges certainly remain. Moreover, given how far apart euro zone countries are in terms of their respective economic recoveries, conducting monetary policy for the area as a whole will be particularly challenging; however, this will be a 2016 story rather than an immediate concern.

Andrew Labelle, Economist
416-982-2556

DISCLAIMER

This report is provided by TD Economics. It is for informational and educational purposes only as of the date of writing, and may not be appropriate for other purposes. The views and opinions expressed may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The report does not provide material information about the business and affairs of TD Bank Group and the members of TD Economics are not spokespersons for TD Bank Group with respect to its business and affairs. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. This report contains economic

analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. The Toronto-Dominion Bank and its affiliates and related entities that comprise the TD Bank Group are not liable for any errors or omissions in the information, analysis or views contained in this report, or for any loss or damage suffered.