TD Economics

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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 provider – this waiver was removed for Greece last month, as the ECB could no longer "assume a succesful conclusion of the programme review". Finally, even if Greece succesfully 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.

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