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June ECB meeting: Slightly less accommodative forward guidance

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- At its regular monetary policy meeting on Thursday 8 June, the ECB Governing Council kept key policy interest rates unchanged and its asset purchase programme of EUR60bn intact until December 2017 (or beyond if necessary), as widely expected. Nevertheless, the ECB adopted a slightly less accommodative forward guidance, removing the reference to "lower levels", expecting interest rates to "remain at present" levels for an extended period of time. According to ECB President Mario Draghi, the removal of the easing bias on interest rates was largely attributed to disappearing deflationary risks.

- The reduced deflation risk was accompanied by improved prospects for the euro area economy. The ECB characterized the risks to the economic outlook as broadly "balanced" instead of "downward" previously, revealing a slightly more optimistic assessment on the growth outlook. In more detail, euro area GDP growth projection was upwardly revised by 0.1pp in 2017, 2018 and 2019 to 1.9%, 1.8% and 1.7%, respectively. However, President Mario Draghi emphasized that the economic expansion needs to feed through to prices, with the ECB lowering its inflation projections throughout the entire forecast horizon on the back of sharper-than-expected appreciation of the trade weighted value of the euro and lower energy prices. HICP inflation was downgraded by 0.2pp in 2017, 0.3pp in 2018 and 0.1pp in 2019 to 1.5%, 1.3% and 1.6%, respectively, while core inflation was also revised to the downside by 0.1pp for 2018 and 2019 to 1.4% and 1.7%, respectively, suggesting a slightly slower improvement for underlying inflationary pressures.

- At the press conference that followed the conclusion of the meeting, the overall tone the President Mario Draghi adopted was more dovish than some expected, highlighting that the Governing Council should be patient and confident in the economic recovery of the euro area adding that ECB's monetary policy needs to be persistent supporting the economy with extraordinary measures for an extended period of time. That said, we expect the ECB to extend its asset purchase programme into 2018, applying a reduction of its pace to EUR35-40bn per month starting from January 2018. The ECB's exit strategy is expected to be very gradual, with both asset purchases and negative deposit rates in place throughout 2018, albeit at less accommodative levels than in 2017.

- The reaction to the ECB's monetary policy decision was contained in Rate markets despite the downward revision to the core and headline figures. Initially the 2-yr German bund yield moved upwards and hit a high of -0.70% after the hawkish amendments in the statement, however it retreated lower soon after recording a low of -0.73% on Friday following the significant downward revisions to inflation. Similarly, the 10-yr German yield fell to a session low of 0.245% on Thursday, the lowest level seen over the last 5 weeks before rising to levels close to 0.262% in the following session. The 2/10-yr Bund yield curve ended Thursday's session unchanged at the level of 99 bps whilst the 5/30-yr spread narrowed by 2bps to reach the level of 156 bps. Periphery spreads and swap spreads faced similar marginal pressures, but were all broadly unchanged making the ECB meeting a relative non-event. European equity markets rose marginally on the day with the EURO STOXX 50 index closing at 3563 points. In FX markets, the lower forecasts for core inflation weighed on EUR/USD which hit a session low of 1.1165 on Friday, marking cumulative losses of c. 1.0% over the last three sessions. Technically, first support lies at recent low which if breached will open the way for further EUR weakness towards 1.1115. EUR/USD implied volatility collapsed after the ECB meeting reaching now levels not seen since late 2014 as investor focus has shifted to the September ECB meeting were significant announcements regarding the tapering campaign to commence in January 2018 are expected.

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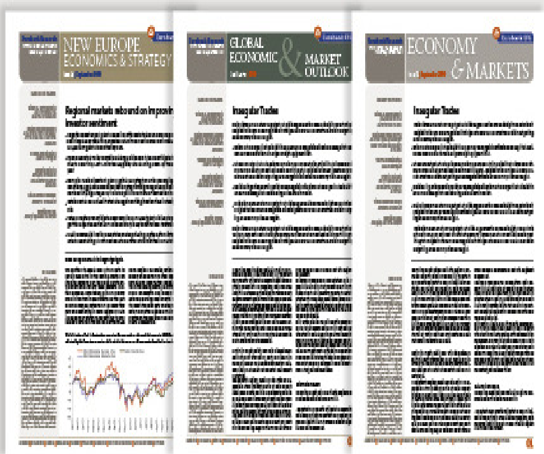

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