ISSN: 1791-35 35

Eurobank Research
www.eurobank.gr/research
research@eurobank.gr

GLOBAL ECONOMIC & MARKET OUTLOOK
October 27, 2017

Eurobank

FOCUS NOTES

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr

October ECB meeting: APP extension at a reduced monthly pace

- As expected, the ECB decided at the October 26 monetary policy meeting to keep its key interest rates stable and extend the asset purchase programme (APP) by nine months to September 2018 at a reduced monthly volume of net asset purchases to €30bn as of January 2018 from €60bn currently. Since the September ECB policy meeting, the economy continued to show signs of recovery with data pertaining to Q3 GDP suggesting that the positive momentum experienced in the first half of the year should be maintained. However, while the improved economic recovery has helped inflation expectations to move higher lately and core inflation to recover from multi-year lows recorded earlier this year, domestic price pressures are still muted overall (Figures 1 & 2).

- To this end, the ECB reiterated at the policy statement issued after the conclusion of the meeting that "am ample degree of monetary stimulus remains necessary" to support a self-sustained durable convergence of inflation to the medium-term inflation target. The ECB's pledge for continued monetary policy accommodation was reinforced by the combination of five decisions:

  (i) The ECB retained its forward guidance on interest rates confirming its expectation that policy rates will remain at current levels "for an extended period of time and well past the horizon of the asset purchases".

  (ii) The QE programme remained open-ended, i.e. no date for the end of the progarmme was announced. As was revealed by President Mario Draghi, the decision was not unanimous but was supported by the large majority of the Governing Council members. Moreover, the ECB President said during the Q&A session that the programme will not "stop suddenly" after September 2018, suggesting that a further extension, albeit at an even lower pace, cannot be ruled out, pushing further away the prospect of an ECB rate hike well into 2019 (Figure 3).

  (iii) The ECB committed to reinvest the principal payments from maturing securities purchases under the programme "for an extended period of time after the end of its asset purchases and in any case for as long as necessary" (Figure 4). Moreover, aiming to provide more transparency, the ECB decided to publish on a monthly frequency, the expected redemption amounts for the asset purchase programme over a rolling 12-month horizon. The data will include the cumulative monthly redemptions for each of the four individual components of the programme (covered bonds, PSPP, CSPP and ABS). The first release is scheduled for November 6.

  (iv) The ECB reiterated its willingness to increase the volume of monthly net asset purchases and/or extend the duration of the programme in case of an upset in financial markets or a sharp deterioration in euro area economic conditions.

  (v) The ECB decided the extension of the fixed rate/full allotment procedure for MROs and 3M LTROs at least until the end of 2019.

- With investors focusing on the ECB President's remarks at the Q&A session that the programme will not stop suddenly in September 2018, German sovereign bonds rallied. The 10-yr Bund yield hit a multi-session low slightly below 0.40% in European trade on Friday (Oct. 27), c. 9bps lower from a peak hit in the prior session ahead of the ECB policy announcement, marking the biggest daily drop over the last two months. As a result, the yield spread against its US counterpart widened to 204bps, the highest since mid-April compared to levels around 196bps in the prior session, ahead of the ECB policy announcement. EMU periphery was well supported with Portugal outperforming. Italy also fared well on reduced political jitters following the approval of the voting system reform bill.

In FX markets, the EUR came under pressure across the board while worries over further escalation of the political crisis in Spain, also had an impact. The Catalan Parliament is likely to vote today on a unilateral declaration of independence while the Spanish Senate meets to vote on Article 155 of the national Constitution which effectively allows the central government to take control of the administrative, economic and budgetary functions of the region. The EUR's weakness was more pronounced against a broadly firmer USD on the back of increased US tax reform optimism on news that the US House passed the Senate Budget resolution overnight, enabling the tax reform legislation, due to be introduced next week, to be approved by Congress without any Democratic votes. The EUR/USD dropped to a three-month low of 1.1610 in European trade on Friday after hitting a multi-session peak of 1.1836 ahead of the ECB meeting on Thursday, marking weekly losses of 1.3%. With the ECB meeting out of the way, market focus turns to the US tax reform legislation and US President's upcoming nomination for Chairman of the Federal Reserve, expected to be publicly announced sometime next week. Recent market reaction suggests that the appointment of incumbent Fed Chair Janet Yellen or Fed Governor Jerome Power could be negative for the USD. On the flipside, US currency could likely extend its recent gains if academic macroeconomist John Taylor gets the top appointment on the view that the FOMC's decision making could be skewed over time towards a more aggressive exit strategy and an expanded balance sheet than is currently the case under Janet Yellen.

Figure 1: Inflation expectations have moved modestly higher in recent months….

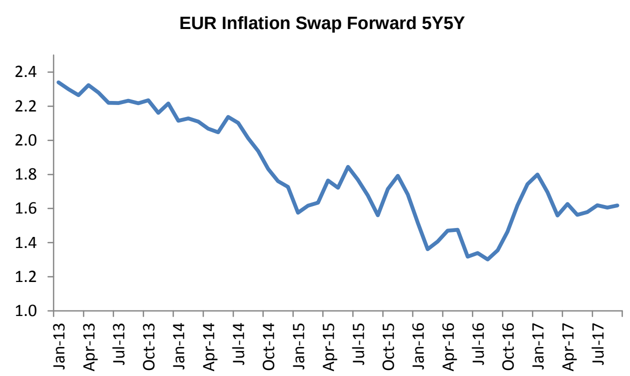


Figure 2- … but inflation pressures still muted overall

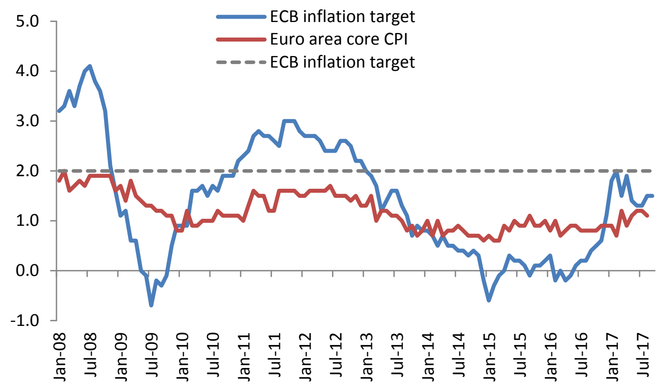


Figure 2- ECB refi rate increase by 10bps expected by Q1 2019 (and cumulative rate hikes of c. 100bps by end 2021)

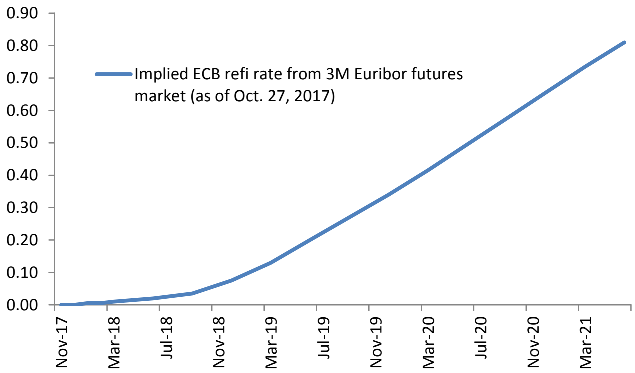
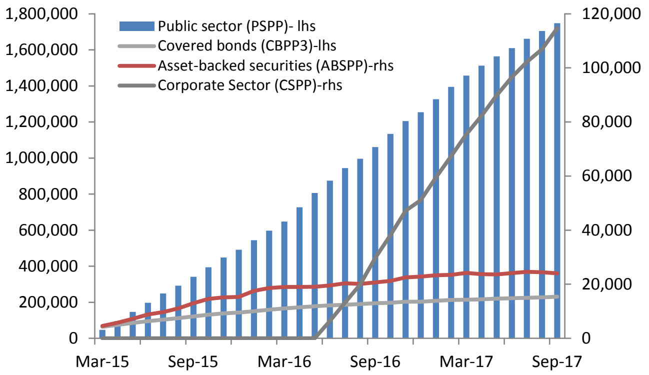


Figure 3- Eurosystem holdings under the expanded asset purchase programme (APP) as at September 2017 (in EUR mn)



Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: Deputy Chief Economist
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793
Ioannis Gkionis: *Senior Economist*
igkionis@eurobank.gr + 30 210 33 71 225
Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226
Olga Kosma: *Research Economist*
okosma@eurobank.gr + 30 210 33 71 227

Marianna Papoutsaki
mpapoutsaki@eurobank.gr + 30 210 33 71 224
Paraskevi Petropoulou: *Senior Economist*
ppetropoulou@eurobank.gr, + 30 210 37 18 991
Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922
Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 33 7 1 228

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

Eurobank Economic Analysis and Financial Markets Research

More research editions available at http://www.eurobank.gr/research

- **Daily Overview of Global markets & the SEE Region:** Daily overview of key macro & market developments in Greece, regional economies & global markets
- **Greece Macro Monitor:** Periodic publication on the latest economic & market developments in Greece
- **Regional Economics & Market Strategy Monthly**: Monthly edition on economic & market developments in the region
- **Global Economy & Markets Monthly**: Monthly review of the international economy and financial markets

Subscribe electronically at http://www.eurobank.gr/research

Follow us on twitter: http://twitter.com/Eurobank