ECB
Money Market
Contact Group

Market Expectations For ECB Monetary Policy

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Overview

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Economic Developments
Growth improving but CPI lagging

GDP: % Change Year-on-Year

Composite PMI

Annual Inflation (%)

Unemployment Rate (%)

Core  Headline
Under the current parameters, technical factors are restricting the ECB’s options for extending purchases at the current pace beyond the end of this year. In December 2016 the ECB decided to remove the yield floor of -40bps to widen the pool of available bonds but the apparent immovable issuer limit of 33% and the unchanged capital key continue to create difficulties. At its current pace of purchases the ECB will be on track to reach the 33% limit in multiple jurisdictions in H1 2018.

Recent ECB data shows that they already seem to be encountering scarcity issues, particularly in Germany where bond purchases in May fell below the capital key for the second month in a row. At the same time, the Weighted Average Maturity (WAM) of monthly German QE purchases declined from 4.7y in April to a new low of 3.99y in May.

As the outlook for the Eurozone economy improves, the ECB are expected to announce QE tapering towards the end of 2017 and reduce the rate of purchases over H1 2018. Net purchases are expected to end by the middle of 2018, depending on incoming economic data.

€234bio was taken down at the final TLTRO in March. Expectations of further near term TLTROs are low, however some market participants expect this to be a key policy tool should further easing be required.
ECB Response
Normalisation debate begins

Early 2018 rate hike is ‘closer to my own expectations’ and ECB tapering could be limited to 5-month period. (Knot, 30th & 31st March, 2017)

Some ECB policymakers had suggested hiking rates before the end of QE stimulus. (ECB sources, 10th March, 2017)

Draghi said he did “not anticipate that it will be necessary to lower rates further” (ECB meeting, 9th March, 2017)

ECB’s current guidance that calls for rates at current or lower levels “for an extended period” and “well past” the end of bond-buying, “could” be shortened.” (Visco, 20th March, 2017)

“We’re sending the same messages to governments, that they have to be prepared for higher long-term financing costs eventually.” (Coeure, 18th May, 2017)

ECB would decide at a later time whether to raise rates before or after its bond-buying program comes to an end.” (Nowotny, 24th March, 2017)

“We should prepare for a change in the policy and as soon as the data is stable and we have a sustainable path towards our objective of price stability then we are well prepared to do (it).” (Lautenschläger, 27th March, 2017)

“Domestic price pressures are still subdued; the same is true for wages. ... current inflation still contains an element of monetary policy.” (Lautenschläger, 31st May, 2017)

“We have to be very careful when people start talking about regime change or normalization change – we are not there.” “We don’t want the markets to overshoot the reality.” (Praet, 15th March, 2017)

“... we cannot yet be sure that the upturn in inflation is sustainable and self-sustained, that it will be there without our monetary policy support.” (Coeure, 18th May, 2017)

“Accommodative ECB policy is still needed.” (Villeroy, 22nd March, 2017)

Despite a firmer recovery, underlying inflation pressures have remained subdued. We still need very accommodative financing conditions, which are themselves dependent on a fairly substantial amount of monetary accommodation.” (Draghi, 29th May, 2017)
Market Developments

Expectations

[Graph showing various financial rates over time, including Eonia Fwd, ECB Deposit Rate, MRO Rate, and ECB Marginal Rate, along with Liquidity Excess in (m) Billions.]
Market Developments
Pricing

2017 Deposit Rate Expectations

[Graph showing deposit rate expectations from January 2013 to July 2017 with key dates labeled and arrows indicating hikes and cuts.]
1Y-1Y Forward Eonia Swap

- 1y1y Forward Eonia
- Eonia Fixing
What does the MMCG think?
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