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TRENDMACRO LIVE!

## On the October ECB Policy Decision

Thursday, October 4, 2012

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**No rate cut, no new policies. Beneath the headlines, the approach to bailouts is changing.**

At the end of the press conference following today's [ECB rate decision](#) there was a brief exchange between ECB President Mario Draghi and Vice President Vítor Constâncio that was picked up by the still-live microphone, perfectly summing up today's ECB meeting:

*Draghi: "A more boring press [conference]"*

*Constâncio: "Markets were not expecting much"*

Very hard to argue with either sentiment.

For the record, there was no change in interest rates and no new policy measures. The only notable thing to come from the conference was an apparent changing of Draghi's willingness to use the OMT (see "[On the September ECB Policy Decision](#)" September 6, 2012) to help Ireland and Portugal.

In the September meeting Draghi said that the OMT would be available to program countries -- Ireland, Portugal and Greece -- "when they are returning to markets." Today he changed -- clarified -- that language to say, "The OMT would not apply to program countries until full market access is achieved."

This change in language is not great news for Ireland and Portugal, who are already starting to [return to the market](#). They will not have ECB help until they have gained *full* market access, by which time, presumably, they will not need that help. That said, the existence of the OMT should still indirectly help those countries somewhat, as bond buyers today should have confidence that the OMT will be available if there are problems in the future.

This slight -- but important -- change to the OMT confirms the evolution in bailout tactics by euro area policy makers that has become apparent over the last several months as the OMT has been developed. Future bailouts will run in parallel with -- rather than instead of -- market access.

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### Update to strategic view

**ECB, EUROPE MACRO:** Expectations for any major move from the ECB today were very low, and the ECB failed to even meet those. The ECB's nuancing of its position on using the OMT to assist existing program countries confirms the changing tactics for future bailouts. Policy makers are determined that countries maintain market access as part of any future bail-out process.

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Fully removing countries from the market, as happened with Ireland, Portugal and Greece, makes it difficult to regain that access later. Maintaining access throughout the process means exit from bailout mechanisms should be much smoother and quicker.

This logic also seems to be at work in the latest -- rumored -- solution to designing a possible future [Spanish ESM bailout](#). Rather than buying Spanish debt in the market, the ESM would offer first-loss insurance to purchasers of Spanish debt. This approach has three important advantages,

- First, it would ensure Spanish access to the markets would be maintained. All new issuances would still go to private investors.
- Second, it would increase the capacity of the ESM. If, for example, it agreed to offer 25% first-loss insurance, the ESM could insure €1.6 trillion of new issuance -- presuming ESM capacity of €400 billion after accounting for the Spanish bank bailout.
- Third, and perhaps most important, it would remove ESM seniority issues. The ESM has declared that any direct purchases it makes would have seniority. As euro policy makers learned in June, there is little bondholders hate more than being subordinated (see "[No Senior Discount for Spain](#)" July 2, 2012). If the ESM is only acting as a credit enhancement, the seniority issue does not arise.

Overall, markets need to look towards the political -- rather than the monetary -- actors in the euro area for the next market-moving event (see "[Bring in the Noise](#)" September 26, 2012). First up on the political side is the Eurogroup meeting in Luxembourg [next Monday](#).

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## Bottom line

Expectations for any major move from the ECB today were very low, and the ECB failed to even meet those. The ECB's nuancing of its position on using the OMT to assist existing program countries confirms the changing tactics for future bailouts. Policy makers are determined that countries maintain market access as part of any future bail-out process. ▶

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