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On the ECB August Policy Decision

Thursday, September 4, 2014

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As we expected, an ABS purchase scheme -- along with a surprise rate cut (the last one).

Today the European Central Bank entered a new phase of easing with an unexpected -- by us, at least -- rate cut to 5 bp on the main rate and to negative 20 bp for the deposit facility. At the same time -- as we have expected for months, and all the more so following President Mario Draghi's [speech at the Fed's Jackson Hole conference](#) (see, most recently, "[Whatever It Takes' Comes to Jackson Hole](#)" August 25, 2014) -- the ECB announced an asset purchase plan.

- In [the statement](#) preceding his monthly press conference, Draghi said:

The Eurosystem will purchase a broad portfolio of simple and transparent asset-backed securities (ABSs) with underlying assets consisting of claims against the euro area non-financial private sector under an ABS purchase programme (ABSPP)... In parallel, the Eurosystem will also purchase a broad portfolio of euro-denominated covered bonds issued by MFIs domiciled in the euro area under a new covered bond purchase programme (CBPP3). Interventions under these programmes will start in October 2014.

- The launch of a third covered bond purchase program is a surprise as the previous two programs are generally considered to have had little effect, with the second being abandoned after only making €16 billion of its potential €40 billion purchases.
- Details of the programs will not be announced until after the monetary policy meeting in October.
- Purchases will start in October. Interestingly, this is before the results of the ECB Asset Quality Review will be released.
- The purchases will include purchases of residential mortgage backed securities -- an asset class that is barred from use as collateral for the Targeted Longer-Term Refunding Operations (TLTRO) due to start in the coming weeks.
- The purchases will be of senior tranches of ABS, but also of mezzanine tranches if there is a guarantee.

Update to strategic view

ECB: The ECB has crossed the Rubicon -- hitting the zero-bound in rates, and committing to an asset purchase program with ABS in October. We expect the program will be in the range of €600 billion. The likely effectiveness of the program is heightened by the fact that the Bundesbank objected to it -- as it did OMT in 2012, a program which ended the global financial crisis once and for all.

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- Draghi committed to today's rate cut being the final rate cut from the ECB -- *this* is the zero-bound.
- Draghi also said that the Governing Council of the ECB is committed to using additional measures should they become necessary. As he has already committed to no more rate cuts, additional measures would almost have to be purchases of sovereign bonds, as the Fed and Bank of England have done.
- While there was no announcement as to the size of the purchases the ECB would undertake, Draghi did say [in response to a question](#) that the ECB's intention was to expand the balance sheet towards its previous peak.
- If we allow for the TLTROs accounting for an expansion of €400 billion, then this puts the purchases in the region of €600 billion.
- While it is important to view these figures as nothing more than a rough guide to what the eventual size of purchases might be, they do certainly point to the intent of the measures announced today.

Perhaps the most bullish sign for today's measures was the lack of unanimous support for them on the Governing Council. We assume that the disagreement came from the Bundesbank -- a dissent from that obstructionist quarter is always, to us, an indication that the policy with which they disagree is necessary and likely to be effective. Thus it was in 2012 when Outright Monetary Transactions (OMT) were first announced (see "[Draghi: Off the Reservation](#)" August 3, 2012) -- an initiative which, looking back on it, ended the global financial crisis once and for all (see "[Whatever It Takes Turns Two](#)" July 25, 2014).

Bottom line

The ECB has crossed the Rubicon -- hitting the zero-bound in rates, and committing to an asset purchase program with ABS in October. We expect the program will be in the range of €600 billion. The likely effectiveness of the program is heightened by the fact that the Bundesbank objected to it -- as it did OMT in 2012, a program which ended the global financial crisis once and for all. ▶

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