



## ECB: 'Broad-based asset purchases', including public QE, within 6 months

- We have updated our ECB QE call. We now see it as more likely than not that the ECB will announce 'broad-based asset purchases', including public QE, within the next 6 months.

We continue to think that public QE – government bond purchases – is neither the solution of the euro-area malaise nor the most efficient monetary policy tool given the euro area economic and institutional characteristics. Private QE along with the AQR/stress tests could be a more efficient tool to address the causes of the persistent, material inflation undershooting. But with private QE offering insufficient size and politics constraining fiscal and structural policies, the ECB is being left with no choice but to push into public QE. Still, we would expect public QE to be less effective in the euro area than in the US.

**What has changed?** First, we have reduced our euro area GDP forecast. Our 2015 GDP forecast is now 1% versus 1.5% in June. We can no longer assume the output gap will narrow in 2015. We still expect inflation to trough in the very short term, but the growth picture combined with softer commodity prices is increasing the risk of a flatter profile to the inflation trajectory.

**Second, we have become even less convinced that the combination of TLTROs and ABS/covered bond purchases allows the ECB to meet at least half of its EUR 1 trillion net balance sheet expansion.** The first TLTRO was disappointing. A still deteriorating environment will give investors reason to hold onto their assets until ECB policy becomes fully credible.

We believe a net EUR 1 trillion expansion of the balance sheet is a strong enough policy to close the gap to the inflation target by 2017. The strongest transmission channel is via a weaker euro exchange rate. **To credibly target a EUR 1 trillion expansion of the balance sheet the ECB needs to move to the next step in the game plan outlined by Mario Draghi back in the spring: "broad-based asset purchases" (BBAP).** In our view, to achieve credible scale this BBAP would encompass euro governments bonds.

**When?** Given our view that GDP growth will be no better than 0.2% qoq until spring 2015, we expect data and events to accumulate and push the ECB into BBAP including public QE within the next 6 months. The ECB will be led among other things by data, the staff preliminary 2017 inflation forecast on 4 December and the second initial allocation TLTRO on 11 December.

**Risks.** A fast enough independent decline in the euro exchange rate could compensate for a BBAP. Rapid resolution of the Ukraine would help too. On the negative side, the political reaction to BBAP – for example, the speed and wording of a possible reaction by German government officials – could be an important determinant of the market's confidence in its durability.

*Today's Focus Europe will include more details.*