



ECB: Private QE in September

- We are bringing forward the timing of private QE (ABS purchasing) to 4 September. Recent weak data and Draghi's latest comments on inflation expectations we think are enough to believe the ECB will supplement the TLTRO in the next few months. Our baseline is to expect this as soon as the next ECB meeting on 4 September, but this is a very close call. An announcement could wait, although the markets will be unhappy to be told that inflation expectations are potentially dis-anchoring if the ECB has no new policies to announce.
- What we expect is not generic QE with government bond purchases, as other central banks have done. We believe the ECB will engage in private QE, that is, ABS purchasing as a complement to the TLTRO. If private QE does not emerge in September, we think it will follow shortly thereafter.

Our baseline had been to expect the ECB to initiate private QE in early 2015. Our view is that the ECB won't want to take any chance with the capacity of the TLTRO to alone end this protracted period of low inflation. We thought the preliminary staff estimates for 2017 HICP inflation, to be published in December, could be the trigger for private QE or to at least give rise to a more vocal debate on QE.

Mario Draghi's speech in Jackson Hole was significant, in our view. It opens the door to earlier action by the ECB. It is a close call, but we now think the ECB will announce private QE (ABS purchasing) on 4 September. There are several reasons for the faster move to private QE.

First, recent real economy data have been disappointing, e.g. Q2 GDP and August PMI. There are several distortions which might have weighed on GDP in Q2, overpowering the underlying momentum of the recovery. This includes weather and holiday effects. The geopolitical uncertainties of the Russia/Ukraine situation might have also have dragged. The geopolitical effects are lingering into H2. We recently reduced our forecast for euro area GDP growth in 2014 to 0.8% (from 1.1%) in 2015 to 1.3% (from 1.5%), but most of this revision was due to the weaker than expected Q2 2014. There remains vulnerability in growth expectations for H2 and into 2015, as hinted at recently by the Bundesbank in its monthly report.

Second, HICP inflation has continued to undershoot expectations. In fairness, the downside surprises this year come predominantly from food prices. Core inflation, though a little volatile, has effectively moved sideways this year around 0.8-0.9% yoy. The trouble is the Russia story is now spilling into the inflation debate. Russia's ban on imports of certain European foods is set to increase supply and dampen prices further. The low point in the HICP inflation cycle has not been reached yet.

Third, although credit flows were better recently (and the credit impulse positive) and signs of some (limited) improvement in bank funding costs and margins are perceptible, the benefits of the TLTRO are lagging and might not have a strong enough bearing over current conditions to quickly stabilise growth and inflation expectations.