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Subject: Fwd: The ECB Loosened Policy Aggressively, Supporting our Eurozone Outlook and Portfolio Positioning

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Begin forwarded message:

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Subject: The ECB Loosened Policy Aggressively, Supporting our Eurozone Outlook and Portfolio Positioning

Date: March 10, 2016 at 5:07:54 PM EST

To: "[REDACTED]" <[REDACTED]>

March 10, 2016

The ECB Loosened Policy Aggressively, Supporting our Eurozone Outlook and Portfolio Positioning

The ECB loosened policy aggressively at the March 10th Governing Council Meeting. The ECB lowered policy rates, expanded asset purchases, provided additional liquidity for banks, and reinforced its forward guidance. These measures should lower the cost of funding for banks and corporates, and support a gradual economic recovery in the Eurozone, in line with our Outlook.

- **The ECB lowered its benchmark interest rates** (main refinancing rate: -5bp to 0%; deposit facility rate: -10bp to -0.4%).
- **The ECB increased the pace and scope of its Asset Purchase Programme (APP).** Planned monthly purchases increased from EUR 60bn to 80bn per month. Importantly, the ECB's purchases will now also include euro-denominated bonds issued by Eurozone non-financial companies. The ECB also raised the limits on international bonds it is prepared to hold in the APP.
- **The ECB announced 4 new targeted long-term refinancing operations (TLTRO) for Eurozone banks.** Banks will be able to borrow from the ECB for 4 years, at rates between the MRO and deposit rates (currently 0% and -0.4%). The rate will be lower the larger banks' new lending to households and companies.
- **Finally, the ECB reinforced its forward guidance.** The Governing Council reaffirmed that it intends to keep rates "at current or lower levels" for an "extended period of time," specifying that this will go "well past the horizon of our net asset purchases" (March 2017 at present).

Today's ECB announcements support our Eurozone outlook. Year to date, lower growth outside the Eurozone, tighter financial conditions, and a stronger euro had become a headwind to growth. The decisions adopted today by the ECB should partly offset those headwinds, especially by lowering the funding cost for the corporate sector and boosting lending via the new TLTROs. Overall, we continue to expect Eurozone GDP growth of 1.25 – 2.0% in 2016. We continue to expect only a very gradual pick-up in inflation, however.

The combination of today's interest rate and quantitative easing decisions with the new forward guidance should help to keep short term euro area interest rates very low for a very long period of time, possibly into the end of the decade. This will enhance European and global growth, and allow the Federal Reserve to be able to gradually normalize interest rates, supporting our underweight duration position.

Today's easing package has important implications for the euro and European equities. The interest rate differential will remain firmly favourable in the medium run towards a weaker euro, but the suggestion that short term interest rates may not be cut deeper into negative territory has disappointed markets, which were priced for further rate cuts later in the year, and triggered a violent appreciation of the euro. We expect that once markets settle down the euro will resume a gradual depreciation to reflect this new easing package and remain comfortable with our short EUR position.

Similarly, we expect that the renewed focus on credit easing – via the purchases of corporate bonds and the incentives to lend embedded in the new TLTROs – and the steps to protect banks' profitability from the impact of negative rates should be positive for Eurozone equities in the medium term.

Thank you and please let us know if you have any questions.

Investment Strategy Group

(1) Excluding loans to households for home purchases.

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