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FOCUS NOTES

December ECB meeting: A less dovish than expected monetary stimulus package

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- In an effort to support euro area economic activity and address the risk of a too prolonged period of low inflation, the ECB Governing Council decided at its regular monetary policy meeting on Thursday 4 December to cut the interest rate on the deposit facility by 10 basis points to -0.30%, with effect from 9 December 2015. The interest rates on the main refinancing operations and on the marginal lending facility were left unchanged at 0.05% and 0.30%, respectively.

- At a press conference that followed the conclusion of the meeting, President Mario Draghi also announced an extension of its asset purchase programme (APP) by six months until the end of March 2017, or beyond if necessary, and in any case until there is "a sustained adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2.0% over the medium term". Furthermore, Mr. Draghi announced reinvestment of the principal payments on the securities purchased under the APP as they mature, for as long as needed, aiming to extend the degree of monetary accommodation after March 2017 when the first 2-yr securities purchased under the APP start redeeming. Moreover, full allotment in main refinancing operations (MROs) and 3-month longer-term refinancing operations (LTROs) will be extended until at least the end of 2017, implying that financial institutions can borrow unlimited amounts at a fixed rate (the refi rate). Last but not least, the ECB increased the range of assets that can be purschased under the APP including euro-denominated marketable debt instruments issued by regional and local governments located in the euro area, aiming to somewhat contain any potential bond scarity worries for the remainder of the programme.

- As regards the economic and inflation outlook for the euro area, the ECB expects annual real GDP to increase by 1.5% in 2015 (from 1.4% in September), 1.7% in 2016 (unchanged) and 1.9% in 2017 (from 1.8% in September), with risks to the euro area growth outlook regarding global economic slowdown and broader geopolitical risks. Separately, annual HICP inflation is seen at 0.1% in 2015 (unchanged), 1.0% in 2016 (from 1.1% in September) and 1.6% in 2017 (from 1.7% September). Low inflationary pressures reflect primarily sizeable economic slack that has negative impact on domestic price pressures and headwinds from the external environment.

- Responding to a relevant question in the Q&A session following the conclusion of yesterday's ECB meeting, Vice President Vítor Constâncio suggested that, under certain conditions, the reintroduction of a Greek collateral waiver (*i.e.* the reacceptance of bonds issued or guaranteed by the Hellenic Republic as eligible collateral in the ECB's regular liquidity provision operations) could take place before the conclusion of the 1st programme review. In more detail, he pointed out that "what regards the waiver, the main condition is that the Governing Council will be satisfied that the country under a programme is complying with the programme, and that could even happen before the conclusion of the review, if we would be close enough to that end of the review and we would be convinced that the review would become successful". As regards the prospect of the ECB starting to purchase Greek sovereign bonds under the QE programme, the Vice President said that this issue "is more complex and it does not depend only on the successful completion of the review".

- Judging from the market reaction, the ECB's stimulus package was perceived as less aggressive than previously expected, as it did not include, inter alia, an increase in the the €60bn monthly asset purchases and/or the removal of the yield floor for government bond purchases, while the ECB President refrained from answering in a relevant question in the Q&A session whether there is more room for a further reduction in the deposit rate. Moreover, the 6-month extention of QE was in line with market expectations, while they expected a rate cut in the deposit rate no less than 15bps. Against this background, the majority of global equity markets were weaker on Friday, while bond yields moved higher. The yield on 10-yr German Bunds was hovering around 0.691% earlier today from levels around 0.470% on Wednesday, marking the biggest two-day jump in nearly 7 months. In FX, the EUR gained across the board with the EUR/USD standing close to 1.0930/35 in New York trade today, within distance from multi-week highs of 1.0980 recorded yesterday, and above levels around 1.0540 marked shortly before the announcement of the ECB's monetary policy outcome.

- Looking ahead, we do not expect the ECB to provide any further stimulus package any time soon, as a recent flurry of euro area macro data suggests that the euro area economic recovery continues to show resilience to lingering downside risks. Furthermore, the Central Bank needs some time to assess the impact of yesterday's measures before it decides to act again, if needed. Yet, on a longer term basis, we do not rule out entirely the prospect of additional monetary policy easing measures including a reduction in the deposit rate, especially in case the EUR extends its recent gains or/and euro area inflation remains at current low levels for longer than expected or/and risks to the domestic economy mount.

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