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ECB October Meeting: No tricks, and a small treat

Yesterday, 26th October, the European Central Bank (ECB) unveiled its widely anticipated QE departure plan. From January 2018, the bank's quantitative easing (QE) program, under which it buys €60 billion (Bn) worth of corporate bonds per month, will be slowed to a rate of €30bn-a-month for an initial nine-month period. The ECB had no tricks up its sleeve and delivered in-line with market consensus expectations. There was an additional dovish 'treat' in that Mario Draghi, the ECB President did not put an expiry date on the program – meaning that it could be extended beyond the nine month timeframe if required. This decision would be largely data-driven. The refinancing rate was held steady at 0% and the deposit facility rate remained at -0.4%. At the detriment of banks, crucial information for borrowers, is that the ECB does not expect to begin rising rates until "well past the end" of the QE programme. The dovish approach prevented markets from getting spooked.

In the fixed income space, more investors turned to Eurozone bonds causing prices to rise and yields to decline. Whilst the 10-year yield on the German Bund came down, the biggest sigh of relief came from peripheral countries and there was visible spread tightening against the Bund.

The euro weakened against the dollar. As Mr Draghi has mentioned, keeping a lid on the appreciation of the euro (which has already appreciated some 12% against the dollar this year) is key for the ECB because if the currency appreciates further, there is a danger that this could exacerbate the economic inequalities between EU states, calling for further ECB intervention down the line.

European equities rose in afternoon trading, though gains were also attributable to relief around developments in Catalonia.

The overall outcome of the meeting was positive and reassured financial markets that the European recovery was solid and broad-based. Draghi referenced the Eurozone's 'unabated' growth momentum in the second half of the year, falling unemployment (currently 9.1%) and the recent pick-up in investment. He did acknowledge that despite a slight increase in wage growth, domestic cost pressures remain subdued. In September, year-on-year inflation came in at 1.5% – once again missing the ECB's 2% target. Draghi stated that, 'the economic outlook and

the path of inflation remain conditional on continued support from monetary policy. Therefore, an ample degree of monetary stimulus remains necessary.'

The meeting served as a beacon of benign economic conditions allowing for a lighter ECB presence and a gradual lessening of the distortions in financial markets.

Because the outcome of the meeting caused yields to fall, dollar strength and European equity market outperformance, our Sonata portfolios received a boost.

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