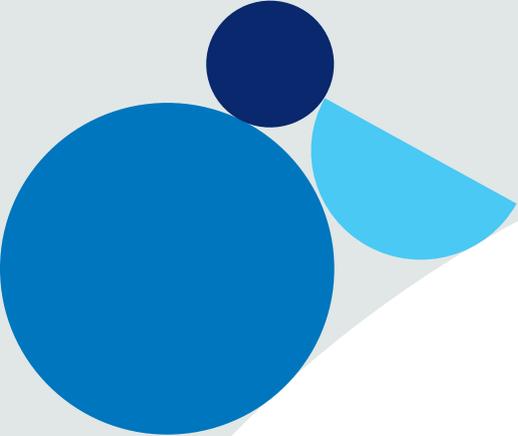


ECB confirms end of PEPP





The ECB has confirmed that PEPP will end in March 2022 and that although the EUR 20bn APP will be increased in size, it will only be for a period of two quarters. Rate increases in 2022 still look unlikely. While overall somewhat more hawkish than expected, the ECB's announcement means that investors now have much more clarity on the monetary policy outlook for the Eurozone next year.

ECB confirms end of PEPP

As expected, the ECB confirmed that the EUR 1.85 trillion Pandemic Emergency Purchase Programme (PEPP) will end in March 2022, with purchases in Q1 2022 to run 'at a lower pace' than in Q4 2021.^[1] The PEPP is currently running at around EUR 70bn per month, mainly purchasing Eurozone government bonds. The ECB left the option open to restart the PEPP 'if necessary, to counter negative shocks related to the pandemic.' However, it seems that the bar to restart PEPP is high and to all intents and purposes this programme is now finishing, though the ECB will continue to reinvest the principal payments from maturing securities until at least 2024.

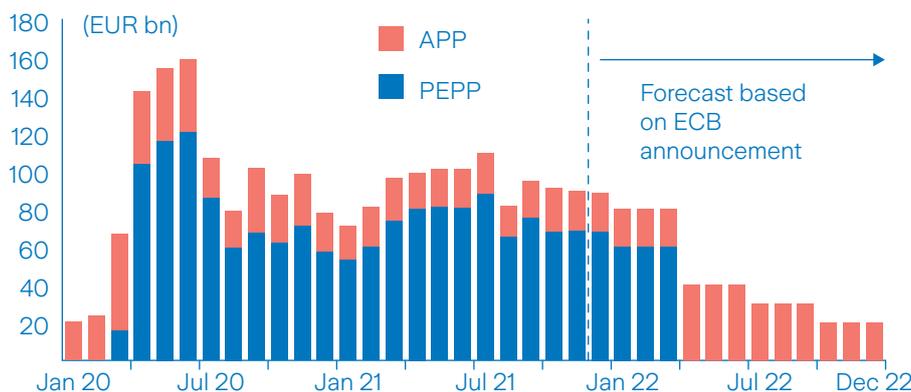
Ramp up in APP is less than expected

The other main development, and perhaps the biggest surprise, was that the ECB will increase its other main securities purchase programme, the APP (Asset Purchase Programme) but by a lower amount than the consensus was probably expecting. The APP was the

original QE Programme that the ECB started in 2015 during the Eurozone debt crisis, when the previous ECB President, Mario Draghi, first crossed the Rubicon and decided to buy Eurozone government bonds. The APP has been running at a constant EUR 20bn a month since November 2019.

Rather than announce a flexible envelope of around EUR 100-200bn of additional purchases for the rest of 2022 as many commentators had speculated that it would do, the ECB simply opted to double the pace of monthly asset purchases under the APP to EUR 40bn Euros for Q2 2022. However, at the same time it also pre-announced that this pace would then be reduced to EUR 30bn per month in 2022 Q3 and then in 2022 Q4 would revert to the original EUR 20bn per month. So this represents 'only' an extra EUR 90bn of securities purchased relative to the baseline APP of EUR 20bn per month in 2022. This was on the low side of expectations.

ECB to taper monthly asset purchases



Source: ECB, Zurich MSME

^[1] Source: www.ecb.europa.eu/press/pressconf/html/press_conference.en.html

Lagarde says rate increases in 2022 are still unlikely

ECB President Christine Lagarde was also asked in the accompanying press conference whether the ECB could raise interest rates in 2022. While she repeated what she has said before that a rate rise in 2022 was unlikely, she did highlight that beyond October 2022 the ECB had left itself a lot of flexibility and optionality with regard to the APP and therefore by implication to interest rates. Recall that the APP is due to end shortly before policy rate rises begin, according to the current formulation of ECB policy.

Conclusion

Overall, the ECB's December 16 monetary policy meeting and accompanying press conference was more hawkish than expected, explaining the market reaction on the day with periphery bond yield spreads widening and core Eurozone bond yields rising modestly. The euro was also stronger versus the US dollar after the ECB announcement.

The ECB's more aggressive tapering of asset purchases than expected is understandable given recent developments in inflation, with headline Eurozone inflation running at a record high of 4.9% YoY in November for example. As Lagarde herself said, this is in large part due to record-high energy inflation due to high oil and natural gas prices. However, it probably is making the ECB uncomfortable continuing with a large amount

of asset purchases indefinitely and would certainly make communicating such a policy extremely challenging.

Nevertheless, the ECB will still be providing a substantial amount of monetary policy support in 2022, especially in the first half of the year, and rate increases still look to be a long way off. Indeed, the good news is that investors now have a lot more clarity regarding the ECB's monetary policy in 2022. Purchases of securities will gradually be tapered over the course of the year, while still preserving some flexibility and optionality for the ECB, and an interest rate hike in 2022 still looks unlikely. This extra clarity on monetary policy should provide some support for risk assets in the region, even if the announcement was not as dovish as some investors may have hoped.

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