

Market Comment | ECB actions disappoint dovish markets

Global Financial Markets Unit 03 Dec 2015

- ECB 3 December meeting. At today's monetary policy meeting the ECB Governing Council (GC) decided to cut the deposit facility rate by 10bp to -0.30%, a historical low. The GC maintained both the main refinancing rate at 0.05% and the marginal lending at 0.30%, thus leaving an asymmetric corridor for interest rates. As regards non-standard measures, the central bank decided to: i) to extend the asset purchase programme (APP) until at least March 2017, i.e for six months, ii) to broaden the range of asset purchased (to include regional and local government bonds), and iii) in an effort to reinforce its forward guidance, to reinvest the principal payments on the securities purchased under the APP as they mature for as long as necessary and finally, iv) to extend the FRFA (fixed rate tender procedures with full allotment) at least until the end of 2017. Mr. Draghi said that today's decision was not unanimous, but he highlighted that a large majority was in favour of the package. The tone remained dovish; the easing bias was retained as the central bank reiterated its willingness to act further if needed. The Staff revised its projections only slightly downwards.
- The eurozone PMIs data were revised downward. Eurozone Markit composite PMI final data in November were revised downward (by 0.2 points to 54.2; preliminary data: 54.4), although They increased by 0.2 in the 3Q15 (2Q15: 53.9 points). Along the same lines, the services PMI was revised downwards (by 0.4 to 54.2 points) and stayed unchanged from last month. By country, in Germany, Italy and Spain the composite PMI improved slightly with regard to the previous month. Meanwhile in France, the Markit composite and services PMIs both declined in line with estimates. On another front, eurozone retail sales fell in October, against expectations of increasing (by -0.1% MoM; consensus: 0.2%).
- Mixed data in the US. US jobless claims increased in the week ended 28 November, in line with estimates (by 9K to 269K), while continuing claims rose below expectations (by 6K to 2,161K; consensus: 2,190K). On another front, the ISM non-manufacturing composite index dropped in November more than expected (by 3.2 points to 55.9; consensus: 58.0). Meanwhile, factory orders rose almost in line with estimates (by 1.5% MoM; consensus: 1.4%).
- Yellen said the economy is close to the interest rate normalization process. Fed Chair, Janet Yellen, in its speech before the Congress used an upbeat tone about the US economic outlook "I currently judge that U.S. economic growth is likely to be sufficient over the next year or two to result in further improvement in the labor market," She also added "Ongoing gains in the labor market, coupled with my judgment that longer-term inflation expectations remain reasonably well anchored, serve to bolster my confidence in a return of inflation to 2 percent." Nonetheless, she explained that at current interest level it's important to move slowly "With the federal funds rate near zero, we can respond more readily to upside surprises to inflation, economic growth and employment than to downside shocks," she said. "This asymmetry suggests that it is appropriate to be more cautious in raising our target for the federal funds rate than would be the case if short-term nominal interest rates were appreciably above



zero."

• ECB implemented new measures but market expected more aggressive. Although the ECB finally took further easing measures (mainly cutting the depo rate again and extending the QE until September 2017) - as it pre-announced in the October meeting - the first market reaction after the ECB meeting suggests that markets had been expected bolder measures that those announced today. On bond markets, the German 2Y bond soared (+14bp), while peripheral yields also jumped as the ECB failed to announce an increase in the monthly purchase of sovereign bonds (Spain: +24bp, Italy: +24bp, Portugal: +22bp, Greece: +29bp), increasing the peripheral risk premia. On the other hand, the Fed Chair's testimony before Congress suggests that we are moving close to the start of the normalisation process, boosting US bond yield across the board (2Y: +3bp, 10Y: +11bp). FX reflected the financial markets' disappointment in today's ECB action. The euro appreciated abruptly against the main currencies, especially against USD (EUR: +2.72%). Equity markets dropped sharply across the board, mainly in Europe. The most EUR-dependent sectors (industrial and export sectors) were the most punished after the abrupt appreciation of the euro (Euro Stoxx: +3.0%, IBEX 35: -1.9%, CAC: -3.0%, DAX: -2.9%, S&P 500: -0.1%). On commodity markets, oil prices rebounded today (Brent: +1.8%, WTI: +1.1%) after yesterday's falls and ahead of tomorrow's OPEC meeting. According to media reports, the pre-OPEC meeting ended without a clear decision about oil quota production. Meanwhile, the copper price rose slightly (+0.2%). Despite this improvement in commodity prices, EM currencies showed a mixed performance (RUB: -1.0%, BRL: +1.6%, COP: +0.5%, MXN: -0.8%, CLP: +0.3%).

Update 17.30 CET 03 December, 2015 Table1

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