

# Flash Comment

## ECB meeting: Positive signals ignored

- ECB kept the refinancing rate unchanged at 1.0%. We expect the interest rate to be kept on hold for at least a year.
- Staff projections for growth were revised downwards – in particular for 2009. The ECB projects the economic decline to be slower for the rest of the year than it was in Q1, but does not see positive growth before mid 2010. We believe this is far too negative.
- The purchase of covered bonds for EUR 60bn will be directed towards purchases in both the primary and secondary market. The purchases will start in July 2009 and are expected to be fully implemented at the latest in June 2010.
- Purchases will be limited to covered bonds that fulfil a number of criteria including eligibility for use as collateral for euro system credit operations, circulating volume and rating. The criteria are not as narrow as many observers had expected.
- Trichet did not give details on country distribution of the purchases – only that it “will be distributed across the euro area”. He expects automatic sterilisation, i.e. that the sellers of covered bonds will take less money from the credit operations.
- Trichet mentioned in the Q&A that he was confident that the Latvian government would take appropriate action without changing the currency. Whether this is a signal that they should not devalue is not fully clear.
- He also said that he has talked with chancellor Merkel and confirmed that the ECB acts independently and that they attach a lot of importance to exit strategies.

### Interest rates on hold

The refinancing rate was kept unchanged at 1.0% as expected. There have been plenty of signals from members of the governing council that they are reluctant to go below 1%, although it has never been fully ruled out.

We project that the policy rates will be kept unchanged for at least a year. The ECB will be careful to avoid keeping the policy rates low for too long and we would expect to see the beginning of a hiking cycle in autumn 2010. However, if the very negative ECB staff projections materialise (see below), the ECB will stay on hold for longer.

### Staff projections too negative

Staff growth projections were revised downwards, in particular for 2009. ECB expects Euroland growth to be around -4.6% in 2009 (down from 2.7%) and around -0.3% next year (down from 0.0%). The revision for 2009 to a large extent reflects the surprisingly negative -2.5% q/q growth we saw in Q1 2009 and a downward revision of Q4 2008.

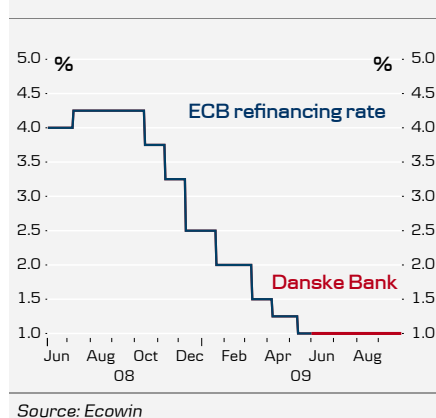
The ECB projects the economic decline to be slower for the rest of the year than it was in Q1, but does not see positive quarterly growth rates before mid-2010. We believe this is far too negative and neglects the many positive signals in recent months from European surveys and Asian hard data. In our view we could see positive growth as early as Q3 this year as inventory reductions come to an end and the economy begins to rebound. We forecast Euroland growth to be around -3.9% in 2009 and 2.0% in 2010.

Staff projections for inflation were revised slightly down to around 0.3% in 2009 (from 0.4%) and kept unchanged at around 1.0% in 2010.

Interest rate (June)				
	Act	DB	Con	Last
Refi rate	1.0%	1.0 %	1.0 %	1.0 %
Deposit	0.25%	0.25 %	0.25 %	0.25 %

Source: ECB and Danske Markets

### The cutting cycle has ended



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## Covered bond purchases

Today we finally got the technical details on how the ECB will go ahead with its purchase of covered bonds. We did not, however, get details on country distribution of the purchases – only that it will be distributed across the euro area. The purchases will most likely be concentrated on covered bonds issued in Germany, Spain and France. The German Pfandbrief market amounts to a third of the total Euroland covered bond market while Spain accounts for almost 30% and France almost 15%.

The purchase of covered bonds will be direct purchases in both the primary and secondary market. The purchases will start in July 2009 and are expected to be fully implemented at the latest by the end of June 2010. This is a relatively long time span, but will make it easier to diversify the purchases.

Trichet said that he expects automatic sterilisation, but also indicated that they would stand ready to sterilise if necessary. In any case EUR 60bn is not a huge amount – it only amounts to about 4% of the Eurosystem's current balance sheet. As such it is not crucial whether it is sterilised or not. The ECB appears to consider sterilisation important for medium- and long-term credibility.

The criteria set out by the ECB for which types of covered bonds they are willing to buy are not as strict as many observers feared. The ECB has decided that purchases will be limited to covered bonds that fulfil the following criteria:

- eligibility for use as collateral for Eurosystem credit operations
- comply with the criteria set out in Article 22(4) of the Directive on undertakings for collective investment in transferable securities (UCITS) or similar safeguards for non-UCITS-compliant covered bonds
- have, as a rule, an issue volume of about EUR 500m or more and, in any case, not lower than EUR 100m;
- have, as a rule, been given a minimum rating of AA or equivalent by at least one of the major rating agencies and, in any case, not lower than BBB-/Baa3
- have underlying assets that include exposure to private and/or public entities

The ECB will purchase covered bonds from counterparties eligible for the Eurosystem's credit operations, as well as euro area-based counterparties used by the Eurosystem for the investment of its euro-denominated portfolios.

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