Investment Event

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ECB trims purchases

The European Central Bank (ECB) has announced "a moderately lower pace" of asset purchases under its Pandemic Emergency Purchase Programme (PEPP)

The move comes as the eurozone recovery progresses and amid more favourable financing conditions in the region

Our views

We do not think this policy decision represents tapering, but rather a reversal of March's uplift in purchases

ECB policy is likely to remain relatively accommodative, supporting the bloc's ongoing economic recovery and equity market performance

Asset purchases trimmed under PEPP

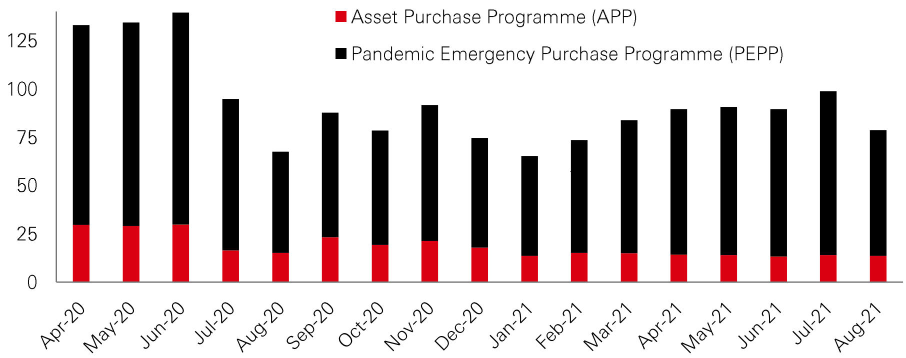
The European Central Bank (ECB) has announced "a moderately lower pace" of asset purchases under its EUR1.85tn Pandemic Emergency Purchase Programme (PEPP) relative to the EUR80bn-a-month level it formally set since March. The decision to adjust purchases lower comes amid a period of rebounding economic activity, stronger-than-expected inflation readings and more favourable financing conditions across the region.

The meeting was a challenge for the ECB which had to balance a substantial upgrade to near-term growth and inflation forecasts, and improving financial conditions against a still-subdued medium-term inflation outlook (at a still-below target 1.7% and 1.5% in 2022 and 2023, respectively) and Mrs Lagarde's previous commitment to "forceful and persistent" policy support.

ECB's decision to reduce asset purchases is not tapering

In our view, the decision to reduce asset purchases is not tapering, but a reversal of March's emergency uplift in purchases – which itself followed an episode of rising bond yields. It means that in Q4, ECB asset purchases will look closer to the levels they were in Q1 this year. It is also important to note that purchases already declined significantly in August (Figure 1).

Figure 1: Monthly ECB net public purchases (EUR bn)



Source: Bloomberg. Data as of 9 September 2021

The Pandemic Emergency Purchase Programme (PEPP) – which accounts for up to 80% of current ECB purchases – expires next March. We think the bigger decision on asset purchases comes at the December ECB meeting. The new symmetric inflation target (i.e. responding when inflation is too low as well as when it is too high), the likelihood of a sharp pullback in inflation next year as temporary distortions unwind, and pandemic risks suggests a dovish tilt to policy for the foreseeable future. This is likely to include ongoing purchases under the Asset Purchase Programme (APP), and a possible extension of the PEPP deeper into 2022.

Macro and investment implications

Overall, with the ECB in no rush to significantly tighten policy, the recovery in the eurozone is set to continue amid high vaccination rates, substantial household savings, and the release of EU recovery funds. We expect GDP to recover to its pre-crisis level by year-end. This supports our positive view on the region's equity markets which benefit from exposure to cyclical and value factors, although strong year-to-date performance may cap the upside potential in the near-term.

Meanwhile, ECB asset purchases provide a critical support to the region's fixed-income markets, which remain overvalued, in our view, amid very tight spreads.

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