

# ECOWEEK

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## ECB: From quantitative easing to quantitative pausing

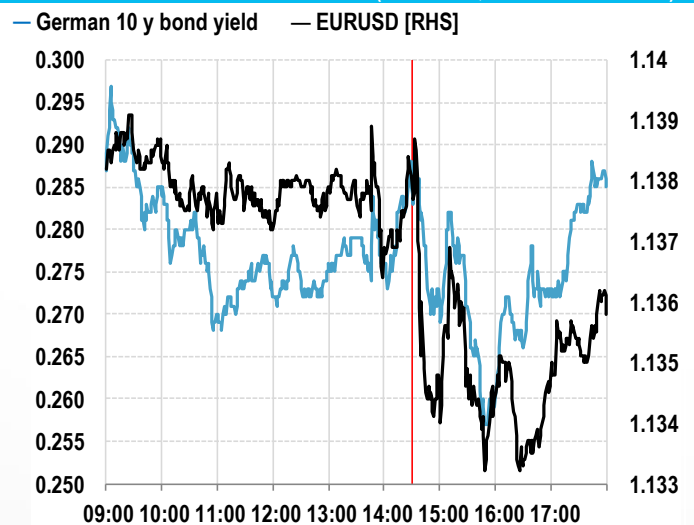
■ As expected, the ECB Governing Council has decided to end the net purchases in the context of its asset purchase program ■ This new phase can be called quantitative pausing, before eventually moving to quantitative tightening, i.e. to shrink the size of the balance sheet ■ The end of net purchases increases the role of forward guidance as an instrument to control interest rate expectations ■ The enhanced forward guidance, i.e. continuing to reinvest for an extended period past the first rate hike, should be welcomed

At its June meeting, the ECB had announced that, subject to incoming data confirming its medium-term inflation outlook, it would end its net purchases by the end of this year. Yesterday's decision was widely expected, so the focus was on the accompanying comments and the technical parameters of the reinvestment. Concerning the latter, flexibility and gradualism seem to be key words so as to safeguard orderly market conditions. This relates to the timing of the reinvestment (the allowed timeframe is now one year) and the changes in the country allocation so as to reflect the changes in the national central banks' subscriptions to the ECB capital<sup>1</sup>. On the other hand, there was no detail on the maturity allocation of reinvestments although the adherence to the principle of market neutrality via smooth and flexible implementation was mentioned. This would indicate that the control of the yield curve will operate via the enhanced forward guidance: reinvestment will continue for an (obviously undefined) extended period of time past the first rate hike. The immediate market reaction (chart) was limited although the slight weakening of the euro probably reflects a more dovish reading by investors based on the forward guidance and on the assessment of the economic environment and outlook, marked by "continuing confidence with increasing caution" and an emphasis on "general uncertainty".

The ECB is now moving from quantitative easing to what could be called quantitative pausing. 'Pausing' because one would expect that as inflation converges sufficiently towards its objective, the ECB would start quantitative tightening by shrinking the size of its balance sheet. However, based on where we are today it is way too early to start focusing on this.

<sup>1</sup> The shares of the national central banks in the ECB's capital are weighted according to the share of the respective Member States in the total population and gross domestic product of the European Union (EU), in equal measure. Following the regular five-yearly adjustment, the new key for subscription to the ECB's capital will enter into force on 1 January 2019. 16 central banks will have a higher share in the ECB's capital than before and 12 central banks will have a lower share. The share of the Banca d'Italia declines from 12.3108% to 11.8023% (source: ECB website).

EUR/USD AND 10 YEAR BUND YIELD (INTRADAY, 13 DECEMBER 2018)



Source: Bloomberg, BNP Paribas.

The ECB press conference started at 14.30 Frankfurt time and lasted for one hour.

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