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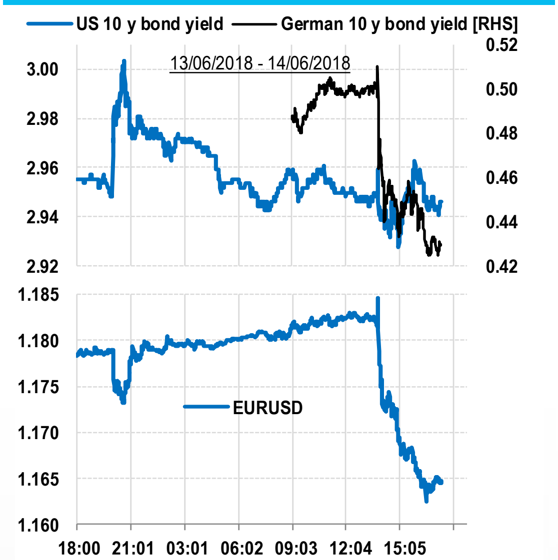
ECB: nervousness postponed

■ Skilful expectations management meant that the announcement of the end of the net purchases of the QE program didn't cause any stirs ■ Markets have applauded the introduction of date and state dependent guidance ■ In the course of next year, nervousness will increase again as investors will wonder whether conditions are met to warrant a first rate hike in this cycle

Markets cheered following the announcement yesterday by the ECB of the widely expected end of the net purchases of its QE program in combination with the unexpected introduction of date and state dependent forward guidance. Compared with the market turmoil (taper tantrum) triggered in May 2013 when Ben Bernanke unexpectedly mentioned that the net purchases by the Fed would have to be scaled back at some future date, the achievement of the ECB is a textbook example of how to manage expectations. Following the speech of Peter Praet in Berlin on 6 June in which he expressed in unambiguous terms his confidence about the inflation outlook, the likelihood that the end of the net purchases would be announced in June had increased significantly. Everybody also understood that the emphasis would shift to the forward guidance if only because governing council members in numerous speeches had insisted on the key role that guidance will play in keeping rate hike expectations under control or, to put it differently, in avoiding that bond yields would rise too much and too fast. Until recently, guidance had left ECB watchers somewhat dissatisfied: presenting it as data dependent is non-committal and the words *"well past"* when talking about the timing of the first rate hike once QE will have ended aren't exactly clear either.

INTRADAY EVOLUTION OF BOND YIELDS AND EURUSD



Source: Bloomberg, BNP Paribas

The jump in equity prices, the drop in bond yields and the euro following the enhanced guidance makes perfect sense. Apart from the surprise effect, the guidance is date dependent with interest rates staying at their current level at least through the summer of next year. Considering that many market participants were of the view that the old *"well past"* meant *"something like six months"*, under the new guidance a hike will come at a minimum three months later, in September at the earliest. This depends to what extent price developments will be in line with the ECB scenario. This is the state dependent part of the guidance, which actually isn't that different from the data dependent guidance of before. This shows that the real innovation yesterday was to commit not to hike before a certain date. This makes combining date and state dependency a very smart move. An added advantage is that doves on the governing council will be pleased that the first hike will come later, and is conditioned by the outlook, whereas hawks will be of the view that a priori September next year will see the first rate increase. Because there's something in there for everybody, the decision was unanimous, which reinforced its announcement effect.

In due course, investors will again look beyond the date dependency and markets will start playing the theme of state dependency by pricing in a rate hike probability which will fluctuate along with the data and the speeches of ECB officials. This would mean at that stage a gradual rise of bond yields and increased nervousness.

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