Morning Comment

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AFS Insights

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Headline Sweep

- EU Fails to Find a United Response to AstraZeneca Vaccine Risks
- Slovakia Unable to Call Russian Vaccine Safe on Lack of Data
- Powell: Fed Can Adjust Administered Rates Between Meetings
- U.S. Offer on Global Tax Deal Would Tie Levies to Revenue
- Yellen Says Tax Plan Recoups $2 Trillion in Overseas Profits
- White House, U.S. companies could agree on 25% tax rate, officials, business groups say
- Russia Says 'No Plans' to Intervene in Ukraine as Troops Mass

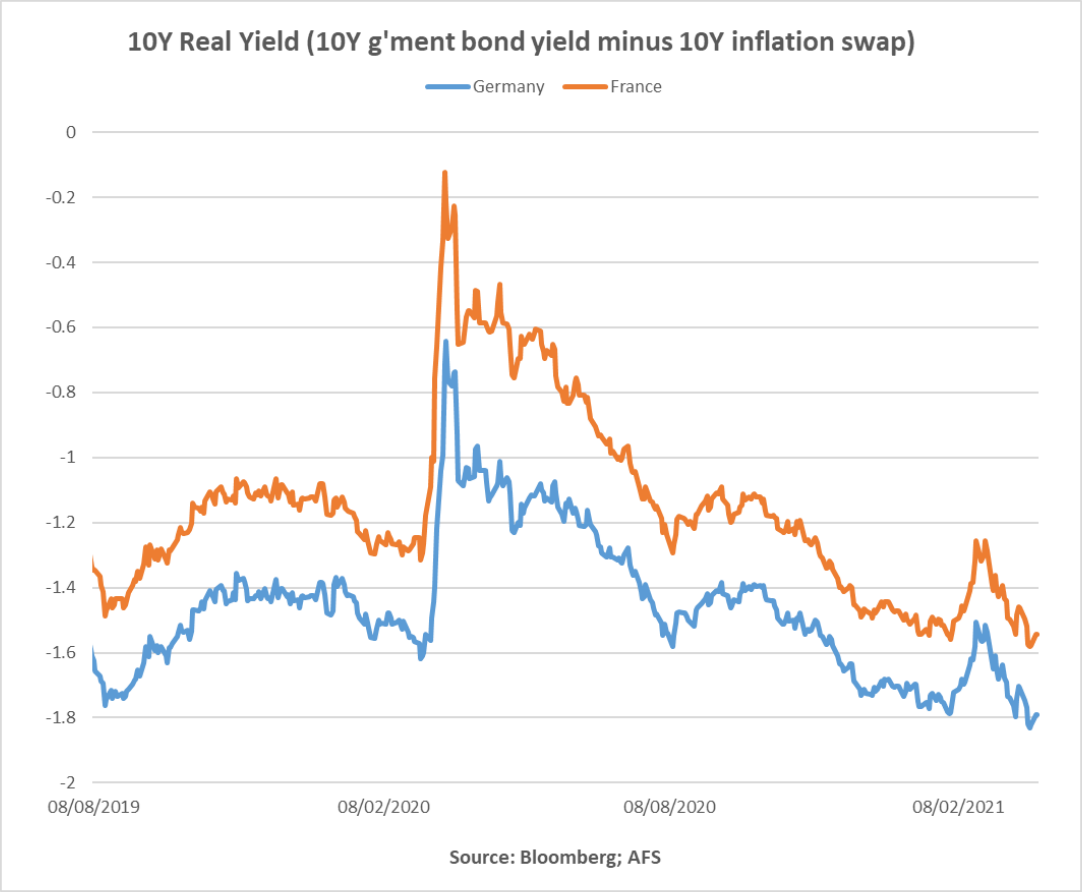
ECB Battle Royale: Belgium vs the Netherlands

- **This week we have the happy coincidence of the central bank chiefs of Belgium and the Netherlands giving detailed commentaries on ECB monetary policy.** In the days of yore – under former President Draghi – it would be an easy call. Ignore the hawks and go with the doves and centrist. We would complete tune out the ramblings of Bundesbank chief Jens Weidmann or his Dutch henchman, Klaas Knot. We fondly remember former Belgian central bank chief Luc Coene dismissing the hawks resistance to President Draghi launching QE as a "theological discussion." Whether or not the central bank should go buy government bonds – this was in late 2014 when President Draghi had just survived a putsch – had become "a matter of faith."
- **But nowadays the roles are reversed.** Ignore the doves and go with the hawks and centrists. The ECB is on track to undershoot its purchase commitment for the pandemic QE program. In fact, back in January the ECB even formalized that it would buy less bonds than advertised if possible. But the doves are nowhere to be found. They haven't put up any resistance to the ECB carefully scaling back its purchase plans. Meanwhile, centrist and doves are both looking for the first opportunity to dial down bond purchases. Of course: the sooner the better as far as the hawks are concerned.
- **Pierre Wunsch, who heads the Belgian central bank and who we consider a centrists, is repeating the line from the Governing Council statement: that the ECB could buy less bonds if market conditions allow the central bank to step back.** In an interview with Reuters he was quoted as saying:

  "We're fine with financing conditions as they are. We're going to use more volumes if we see tightening and less volume if we see that financing conditions stabilize without us buying that much."

According to Reuters he added that a 10bps to 20bps increase in bond yields would not be a problem as long as the bond yield remains below the rate of expected inflation.

- **There is ample room for nominal bond yields to rise without causing a tightening of financial conditions that the ECB wants to prevent**. Since the March Governing Council meeting real rates have fallen to record-lows through a combination of stable bond yields and higher inflation expectations:



- **Reuters also quotes Wunsch as saying that the ECB can only pin down yields "so many months or a year" before letting economic fundamentals reassert themselves**. No surprise here. We read that has him saying that once we are well and truly leaving the pandemic behind us – which we would define as the continent reaching the UK's current levels of vaccinations probably/hopefully by the end of the second quarter – the ECB will allow yields to rise. The ECB will still try to contain yields though. But the pain threshold will be higher than the minus 30bps for the 10y Bund, which translated to a real rate of about minus 150 bps.
- **Wunsch's Dutch counterpart, Klaas Knot, is clearly in a rush to get out of pandemic QE.** Knot told Reuters in an interview that:

  "If the economy develops according to our baseline, we will see better inflation and growth from the second half onwards. In that case, it would be equally clear to me that from the third quarter onwards we can begin to gradually phase out pandemic emergency purchases and end them as foreseen in March 2022."

- **Knot is also parroting Fedspeakers' line that a rise in bond yields is welcome as long as it reflects an improving outlook:**

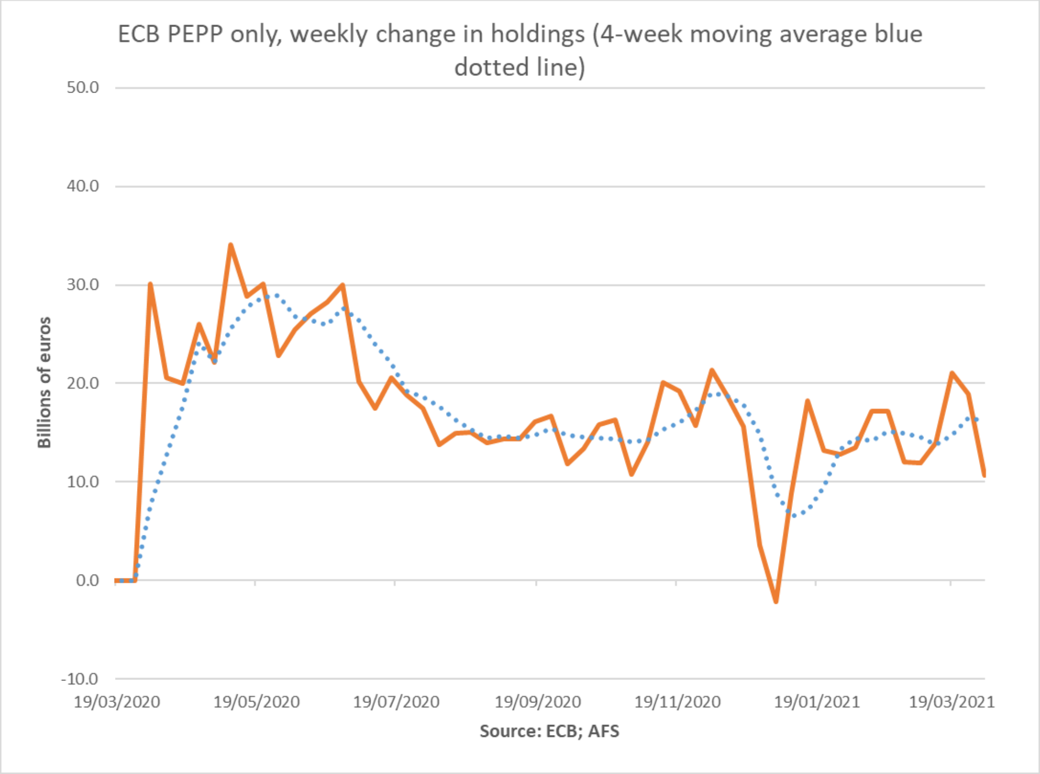
  "To the extent that higher nominal yields are driven by better inflation and growth prospects, to me that's entirely benign. If real rates are roughly constant, it means that higher nominal rates are entirely due to higher inflation expectations and that is something I'm comfortable with."

  Knot added that current real yields are justified at this stage. But notice that, even now, he wouldn't mind an increase in nominal yields now as long as real yields remain broadly flat.
- **We think the hawks smell blood.** They want to curtail pandemic bond buying even further. And we also think the hawks will score another victory. Their first victory was to weaken the purchase commitment of pandemic QE. They are now aiming for an early taper. And what Knot has in mind, is that purchase volumes should be lower than they were in the first quarter of 2021, before the ECB decided to temporarily increase weekly purchase volumes.
- **Confusing**? We identify three phases with regards to average total weekly purchase volumes of *all securities under all programs*. The first phase is the crisis phase that ran from mid-March 2020 to end June of that year, when the TLTRO settlement resulted in an [1]increase in excess liquidity of 558 billion euros overnight. That bumper increase in excess liquidity allowed the ECB to dial down bond purchase volumes. In the crisis phase purchase volumes average 32.6 billion euros a week. In the second phase that ran from July to the end of 2020 purchase volumes averaged a significantly lower 21.7 billion euros. From January 2021 until mid-March weekly purchase volumes averaged 20 billion euros. At the March Governing Council meeting the ECB announced it would temporarily boost purchase volumes because of the worsening pandemic, the recession dragging on and the US Treasury yield spike. In the final weeks of March the ECB duly boosted weekly average purchase volumes to 26.3 billion euros.
- **Now, with regards to Knot's remarks of a "gradual phase out" of pandemic QE from the summer onward, our reading of the tealeaves is this**. In the third quarter, purchase volumes will return to their pre-acceleration pace regardless. But clearly, that is still too high for Knot. We assume Knot's starting point for a taper are purchase volumes as they were during the first quarter, not the higher volumes of late March/the second quarter. Which begs the question: if Knot gets his way, how many bonds will the ECB end up buying by the end of March 2022, when the pandemic QE program is supposed to end?
- **If pandemic QE purchases simply revert to their pre-acceleration pace from the summer onward and where there is no taper, pandemic QE holdings will be 1.74 trillion euros by late March 2022**. That's slightly more than a hundred billion euros below the purchase commitment. We think this is the dovish outcome. Our thinking is that by temporarily increasing purchase volumes in the final weeks of March and the second quarter, the *ECB is only pulling forward purchases that would have otherwise have been made later this year.* Put differently: above average purchase volumes now means below average purchase volumes later. That 'later' is the summer and beyond. In the period from late March to end June we expect total pandemic purchases to be higher by roughly 70 billion euros. That

[1] Note that for our calculations we exclude the last two weeks of 2020 and the first week of 2021, when purchase volumes where artificially low because of the holidays.

amount needs to be subtracted from purchases that the ECB will make in the remaining nine months of the program. So, then the ECB would end up buying 1.67 trillion euros in bonds under pandemic QE. Subtracting those 70 billion euros from purchases the ECB will make in the remaining nine months of the program might constitute a "gradual phase out" of pandemic QE. But we have an inkling that Knot prefers the ECB undershoots even that amount. We'd call the 1.67 trillion euros a baseline, but with the risk clearly tilted toward an even lower amount.

- **We understand the juggling with bond buying numbers is both confusing and might seem pointless.** Regarding the former: with total bond holdings of more than 3.9 trillion euros, does it even matter if the ECB buys another 70 billion euros in bonds? Will anyone notice when excess liquidity net of tiering is more than 3.0 trillion euros? We understand (and share) the frustration with central bank bond buying. But, as recent history has shown, bond buying and ECB-speak on bond buying still definitely matters when it comes the level of bond yields.
- **And regarding the confusing numbers, the problem is that it is hard to visualize purchase volumes when they are volatile from week to week; when the longer term decline in average weekly pandemic purchase volumes is barely perceptible; and when the ECB runs multiple buying programs.** The chart below shows weekly pandemic bond purchases only. The chart doesn't show it, but we and other ECB-watchers did observe a significant decline in purchase volumes in the first quarter.



- **Finally, another way of looking at QE is to keep track of the various programs and envelopes**. As the table below shows, there is the 'regular' QE program, the "temporary envelope" for the regular QE program; and three rounds of pandemic QE:

ECB bond buying table

	Size	Constraints ?	Launch date	Preliminary end date for purchases	Preliminary end date for reinvestments
Asset Purchase Progam (APP), aka 'Conventional' QE	20 billion euros per month	Capital key, 33% issue/issuer limit	Mar/15	For as long as necessary but end shortly before the first rate hike	Well past the date of the first rate hike
QE temporary envelope	120 billion euros in total	As per conventional QE, but with some flexilibity	Mar/20	Summer/early autumn of 2021 (about 2/3 of the envelope has been spent)	At least the end of 2023*
Pandemic QE 1st round	750 billion euros	Flexible/lax capital key, soft yield targetting	Mar/20	used up	At least the end of 2023
Pandemic QE 2nd round**	600 billion euros	Flexible/lax capital key, soft yield targetting	Jun/20 (actual purchases started around January 2021)	At least March 2022, or until Coronavirus crisis over	At least the end of 2023
Pandemic QE 3rd round**	500 billion euros	Flexible/lax capital key, soft yield targetting	01/12/2020 (purchases should start in Q4 of 2021)	At least March 2022, or until Coronavirus crisis over	At least the end of 2023

Source: ECB; AFS. Note eligible bonds are the same for each program (public sector; private non-financial corporate; ABS and covered bonds). However, pandemic QE temporarily included money market paper.

**Reinvestment policy likely the same as for APP*

***At the January Governing meeting the ECB announced that if favorable financing conditions can be maintained with lower purchase volumes, then purhcases are likely t undershoot the purchase commitment*

- **The ECB started to spend the second envelope of pandemic QE as late as January this year.** It was announced a half year before. Now, if the ECB maintains current boosted purchase volumes throughout the second quarter and purchase volumes then return to their levels of early 2021 in the summer, the ECB will have completely spent the second envelope by early to mid-September. Around that time the ECB will probably have also fully spent the remaining amount in the temporary envelope of 120 billion euros.
- **Now, imagine that by the late summer the EU states will have finally completed their vaccination campaigns; with the economy and society having returned to normal for the large part; and with a strong cyclical rebound finally under way: the writing will be on the wall for the third round of pandemic QE.** The hawks' pressure spend as little as possible from the second envelope will be immense. The ECB will probably end up spending half of the third envelope. In other words: while the notional size of pandemic QE is 1,850 billion euros, actual purchases are more likely to be 1,600 billion euros.
- **By March next year, all that will be left will be the 'regular' QE program of 20 billion euros a month**. After all: inflation and inflation expectations will remain depressed. Even the hawks know this, and here we give the final word to Knot:

  "The inflation outlook does not provide any case for tightening our standing instruments, like our forward guidance on rates or the APP," Knot said. "Exiting our emergency measures does not equate to exiting our accommodative monetary stance.""

Calendar

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:45	France	Current Account Balance	Feb	--	-1.6b
09:00	Switzerl.	Foreign Currency Reserves	Mar	--	914.2b
09:30	Germany	Markit Construction PMI	Mar	--	41
10:30	UK	Markit/CIPS Construction PMI	Mar	55.0	53.3
10:30	Spain	Sells 0% 2026; 0% 2028; 0.7% 5.15% 2044 Bonds			
10:30	Spain	Sells 0.7% 2033 Linkers			
10:50	France	Sells Bonds			
11:00	Eurozone	PPI MoM	Feb	--	1.40%
11:00	Eurozone	PPI YoY	Feb	--	0.00%
12:00	Czech Rep.	Sells Up to 5 Billion Koruna of 182-day Bills			
13:00		Riksbank's Floden speech			
13:30		ECB Publishes Account of Its March 10-11 Policy Meeting			
14:30	US	Initial Jobless Claims	Apr/03	--	--
14:30	US	Continuing Claims	Mar/27	--	--
17:00		Fed's Bullard Discusses Economy and Monetary Policy			
17:30	US	Sells 4-Week; 8-Week Bills			
18:00		Fed's Powell Takes Part in IMF Panel on Global Economy			
20:00		Fed's Kashkari Speaks			

Consensus data: Bloomberg News; All Times Are in Central European Time