Deutsche Asset
& Wealth Management

CIO Flash
The new Draghi: what can be expected from the ECB?
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"Super Mario" disappoints

- Last week, markets were caught on the wrong foot by the latest package of measures by the European Central bank (ECB). There was no headline increase of monthly asset purchases, currently at EUR 60bn.
- Investors have grown used to ECB President Mario Draghi over-delivering, earning him the nickname "Super Mario". When Draghi failed to do so this time around, investors were unprepared. On Thursday, the euro strengthened by 3% to 1.09 U.S. Dollars (USD); equity markets sold off. The German DAX was down 3.6%.
- By Friday, ECB officials, including Draghi, were busily trying to calm market nerves, amid hints of more resistance from ECB board members. Draghi may have felt that it was not worth picking a fight right now and that markets would swiftly overcome any disappointment.

The ECB has mismanaged expectations …

- The ECB did decide to extend the duration of its asset-purchase-program (APP) to at least March 2017, to reinvest proceeds and to include purchases of debt issued by regional and local governments. This last move will make any further increases in APP easier to implement, by mitigating any shortages in the debt issued by some countries, notably Germany. The ECB also cut its deposit rate from -0.2% to -0.3%.
- The ECB measures were in line with our expectations. They translate into a sizeable increase in the APP due to the extension and reinvestment. The trouble is that investors had hoped for more. The ECB's credibility has taken a hit and it may take more than words from Draghi next time around.

…providing opportunities for tactical trades

- **Overall, we see no reason to adjust our forecasts.** Last week's initial reaction was largely technical, as many investors had bet on a weaker euro and a rising DAX. When the ECB measures were announced, they had to unwind these positions.
- **Eurozone equities had rallied in the weeks before the ECB announcement.** The moves since last week have simply eroded some of these gains. Moreover, volatility spiked only briefly, before settling to levels on Friday below where they started the week.
- **We remain neutral on German Bunds and positive on government bonds from Europe's periphery.** This is underpinned by the ongoing hunt for yield as more and more euro-government-bond yields are in negative territory.
- **The case for the euro to weaken again against the USD remains strong.** It will be further reinforced should the Fed hike on December 16, which we expect. Although the market was disappointed, ECB policy will remain loose in the upcoming year.
- **Investors have less reason to expect positive surprises from the ECB in future.** Its decisions look set to become more dependent on economic and inflation data rather than market hopes. Betting on "Super Mario" is getting riskier.

Glossary

Explanation of terms

The **asset purchase programme (APP)** refers to purchases of marketable debt instruments by the ECB.

Bunds are issued by Germany's federal government, most frequently with a maturity of 10 years, and are the German equivalent of U.S. Treasury bonds.

The **DAX** is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

The **deposit rate** is the rate banks receive when they make overnight deposits with the ECB

The European Central Bank (ECB) is the central bank for the Eurozone.

The **Eurozone**, also called the euro area, is a monetary union of 19 of the 28 European Union (EU) member states which have adopted the euro as their common currency.

Periphery countries are less developed than the core countries of a specific region. In the Eurozone, the **euro periphery** consists of the economically weaker countries such as Greece, Portugal, Italy, Spain and Ireland

Volatility is the degree of variation of a trading-price series over time.

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