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European Bond Market Outlook

ECB Bond Contact Group, 21 June 2016

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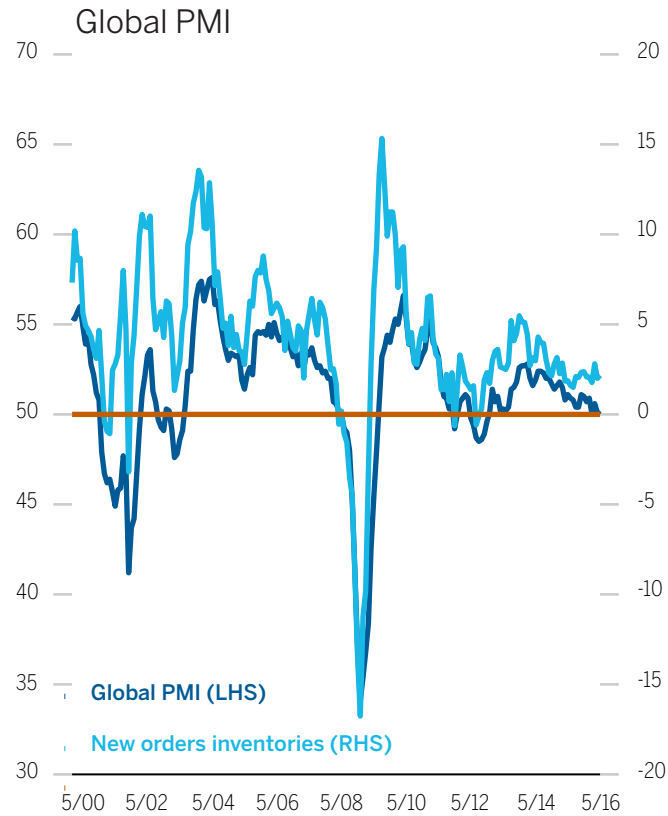
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Macroeconomic Framework

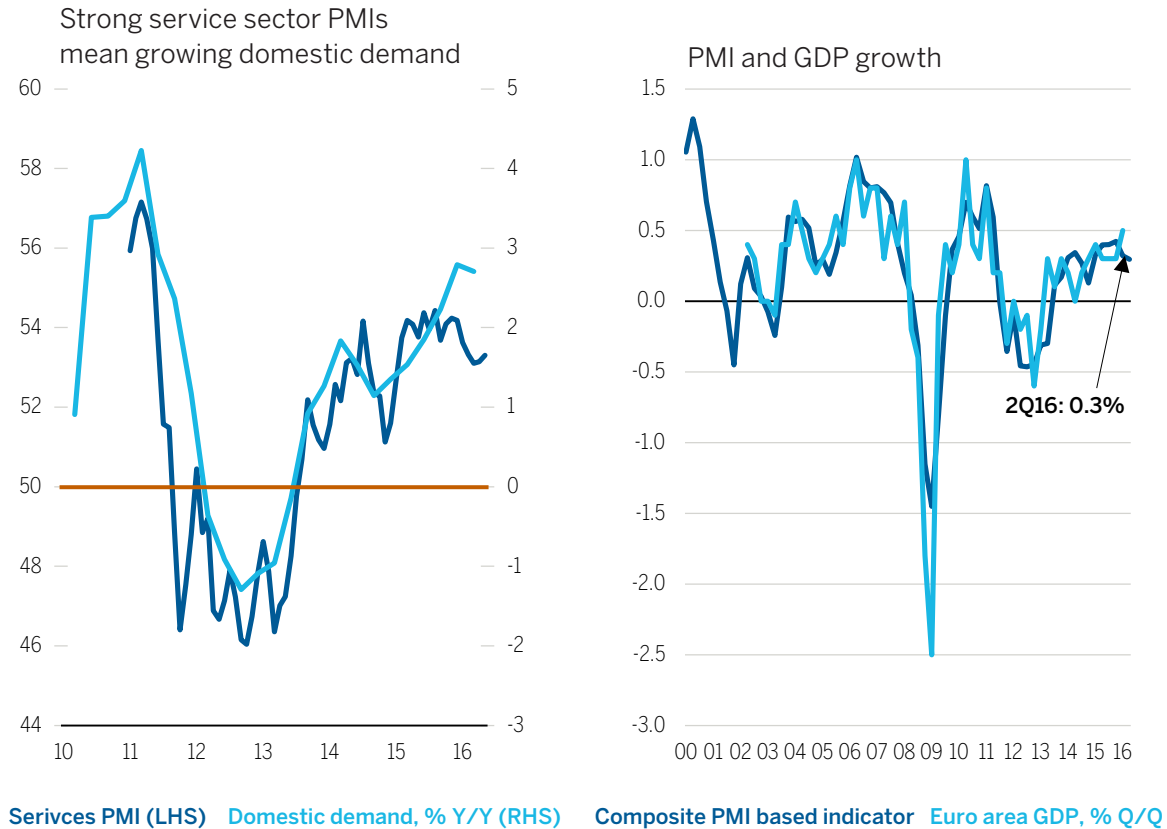
Global cycle sluggish...

...improvement in US and China, rotating from Japan and Europe



Macroeconomic Framework

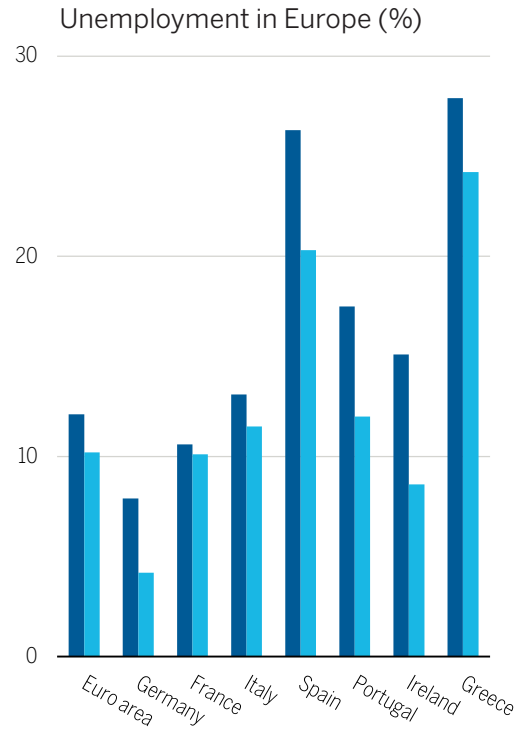
Improving service sector PMIs mean growing domestic demand...
...sequential improvement is modest in composite PMI and GDP



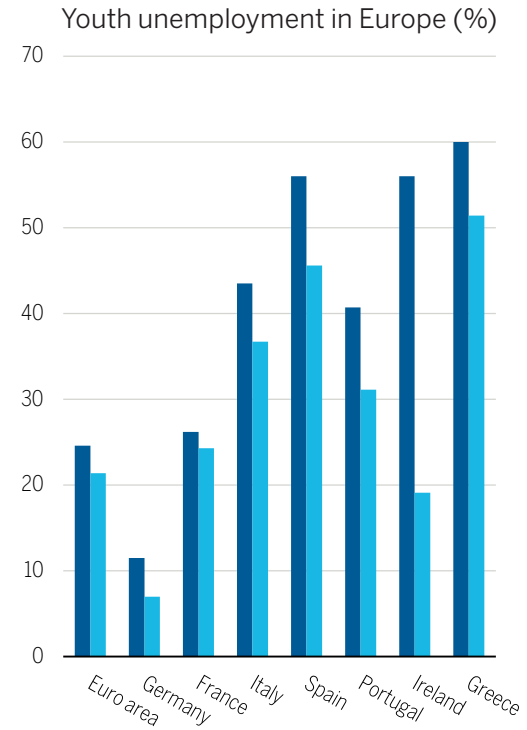
Sources: European Commission, Haver

Macroeconomic Framework

European unemployment meaningfully below peak...
...whilst youth unemployment remains high



Peak UE (2008 – Mar 2016)

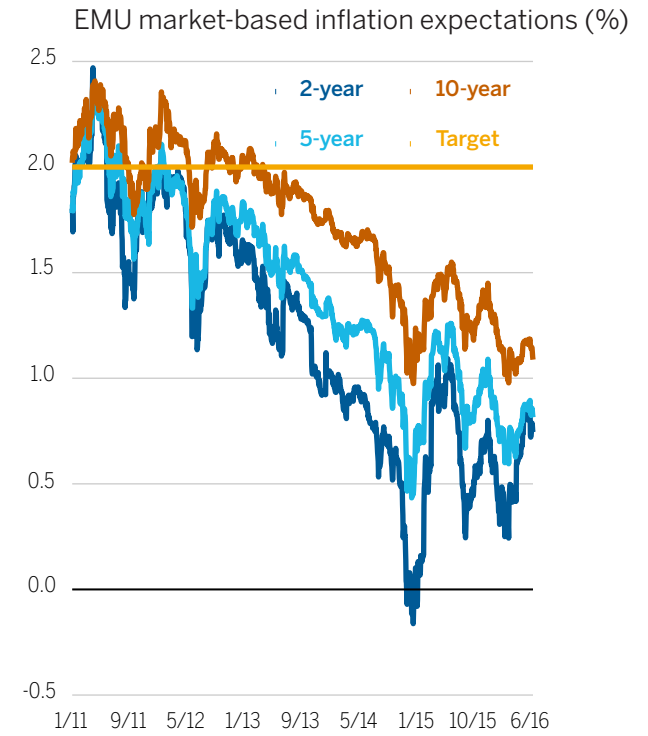
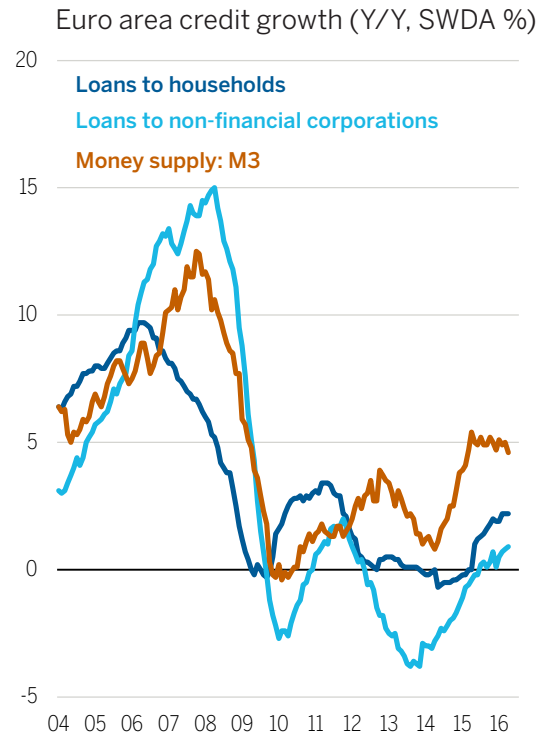


As of Mar 2016

Note: Youth unemployment defined as number of unemployed age 25 or younger. | Sources: Haver, Eurostat

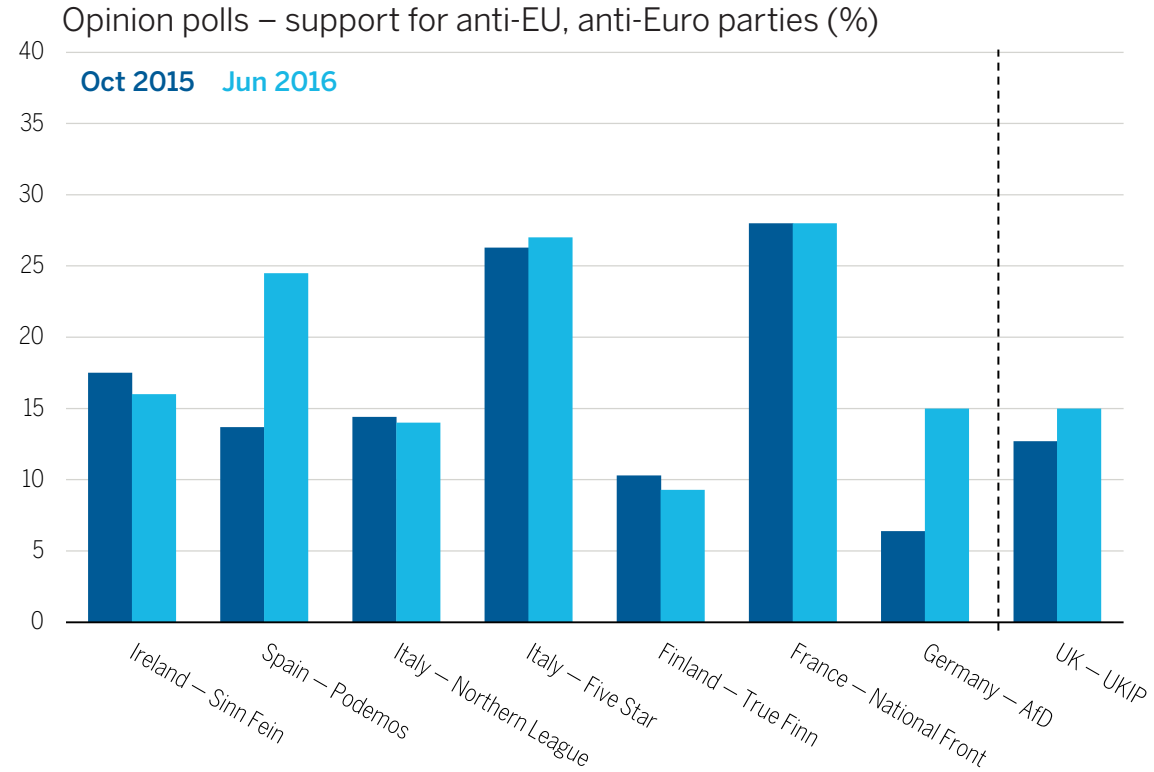
Macroeconomic framework

European credit growth is increasing...
... yet inflation expectations are still low



Macroeconomic framework

Populist political parties are gaining support across Europe...
...and remain a big risk

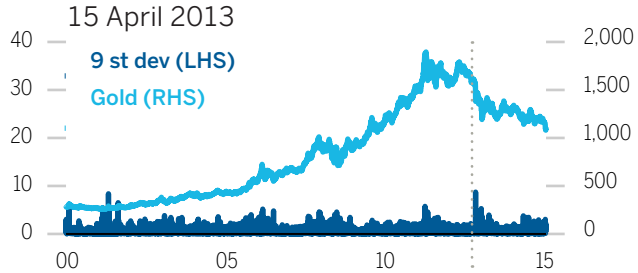


Note: No polling data available for National Front in June and for True Finn in August | Source: National polling agencies

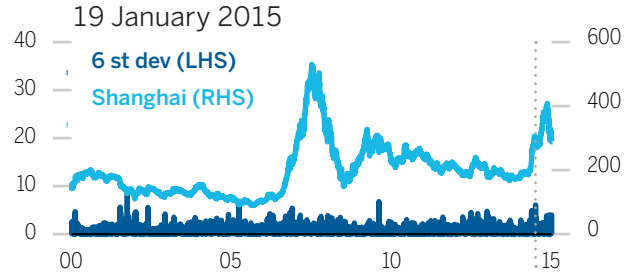
Macroeconomic Framework

Liquidity is not just an issue in corporate bonds markets

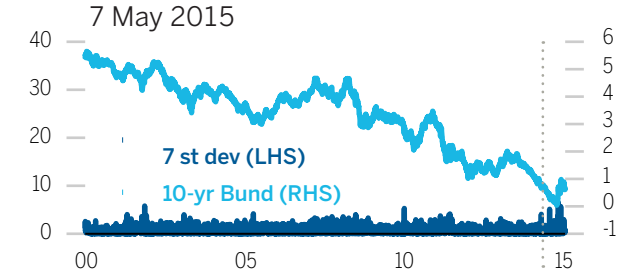
Daily absolute price moves expressed as multiple of 1-yr standard deviation



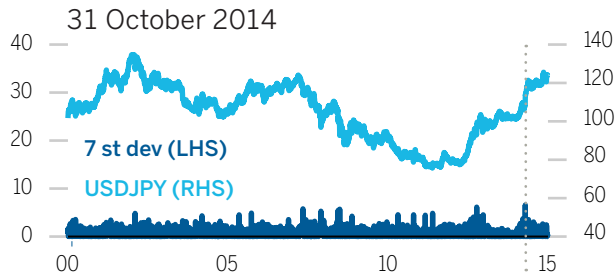
"Gold plunged the most in 33 years amid record-high trading as an unexpected slowdown in China's economic expansion sparked a commodity selloff from investors concerned that more cash will be needed to cover positions."¹



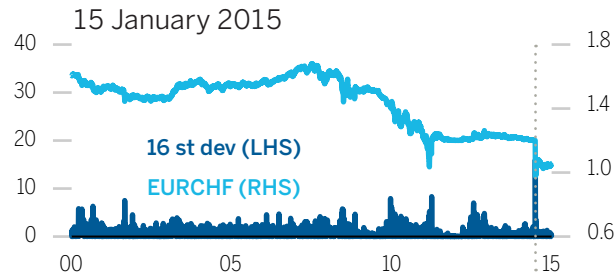
"Shanghai's stock market suffered its worst plunge in more than six years on Monday, after authorities cracked down on a risky lending practice used by the China's biggest securities brokerages."²



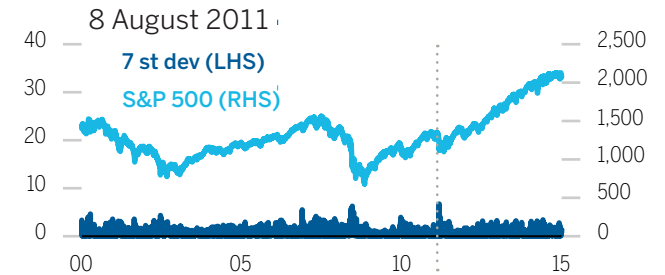
"Traders were unable to pinpoint a single factor driving the selloff. Some said catalysts included the poorly received French government-bond auction and Wednesday's comments Janet Yellen, chairwoman of the US Federal Reserve, about valuations in stock and credit markets."³



"The pair jumped after a surprise announcement by the BoJ to increase stimulus by raising its monetary base target to JPY 80 trillion annually."⁴



"The Swiss central bank has abandoned its exchange rate control and cut interest rates to -0.75 pc, sending the franc soaring against the single currency."⁵



"Black Monday 2011 refers to 8 August 8 2011, when US and global stock markets crashed following the Friday night credit rating downgrade by Standard and Poor's of the United States sovereign debt from AAA."⁶

Sources: Haver Analytics, ¹Bloomberg, ²The Guardian, ³The Wall Street Journal, ⁴FXStreet.com, ⁵The Telegraph, ⁶Wikipedia

Asset Purchase Programme

Evidence points to ECB frontloading in April 2016 and May 2016

ECB cumulative purchases reach €1 trillion

In both April 2016 and May 2016 the total purchases were above the €80 billion target

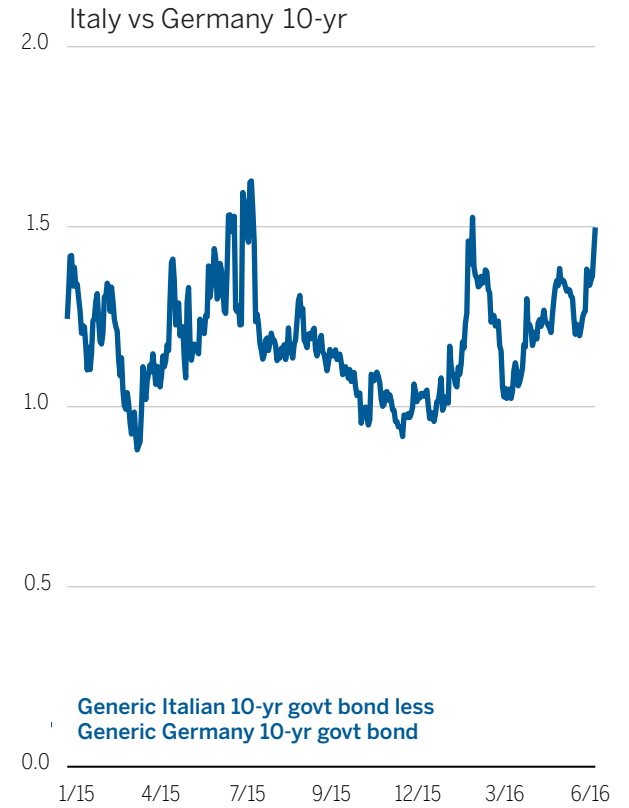
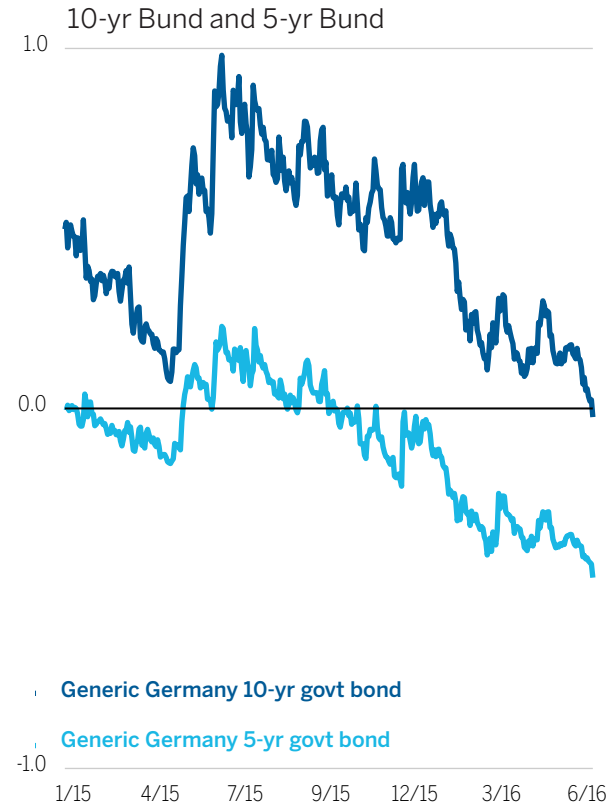
Between March 2015 and March 2016 the Public Sector Purchase Programme (PSPP) averaged 83% of asset purchases, during April 2016 and May 2016 this average increased to 93%

	PSPP			CBPP3	ABSSPP	Total
	Government bonds and agencies	Supranationals	Total			
Cumulative ¹	717.1	95.4	812.5	177.8	19.1	1,009.4
Average (March 2015 to March 2016)	44.3	6.1	50.4	8.9	1.2	60.5
Average (%)	73.2	10.1	83.3	14.7	2.0	–
April 2016	69.8	8.7	78.5	6.6	0.0	85.2
May 2016	72.0	7.7	79.7	5.6	0.0	85.2
Average (April 2016 to May 2016)	70.9	8.2	79.1	6.1	0.0	85.2
Average (%)	83.2	9.6	92.8	7.2	0.0	–

¹At amortized cost | Monthly size of ECB purchases and cumulative amounts spent last day of the week shown on a settlement basis € bil | Source: ECB

Asset Purchase Programme

Government bond yield developments



Asset Purchase Programme

Who's been buying and selling?

Domestics have been net sellers except insurance companies who have been net buyers

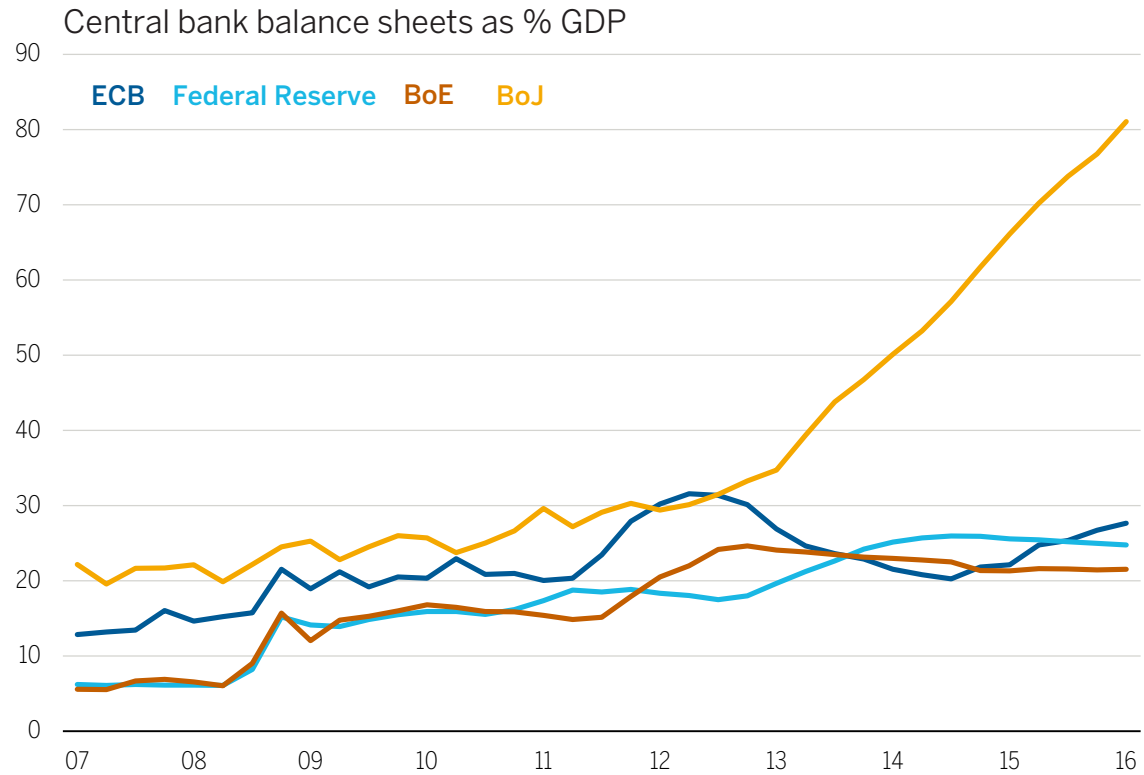
Japanese investors have been buying during 2016

Monthly avg	Net govt issuance	ECB		Domestics						Foreign		
		QE ¹	SMP	Total	MFI	Inv fund ²	Ins co ²	Pension funds ²	Other domestics	Total	Japan ³	Other
2014	26	0	-3	28	6	5	6	2	9	1	-1	2
1Q15	48	14	-1	3	15	10	5	1	-28	32	2	30
2Q15	15	44	-2	-16	-8	0	5	0	-13	-10	-8	-2
3Q15	0	42	-2	-19	0	2	-3	1	-19	-21	1	-21
4Q15	-4	44	-2	-32	-28	-5	-1	0	2	-15	2	-16
Jan 16	52	47	0	-5	56	-7	NA	NA	NA	10	6	3
Feb 16	8	47	-2	-13	13	-7	NA	NA	NA	-25	5	-30
Mar 16	85	47	0	-8	-5	-7	NA	NA	NA	47	4	43
Apr 16	-35	70	-7	-29	-7	NA	NA	NA	NA	-69	-1	-68
QE avg (Mar 15 – Apr 16)	14	46	-2	-20	-5	-2	1	0	-12	-10	0	-10

¹Includes a small portion of agency purchases | ²Quarterly data evenly split across months, in line with flow information | ³Japanese Ministry of Finance provides a sub-split on government securities net flows for only Germany, France, Italy and Netherlands. | Source: ECB, Japan BoP, JPMorgan

Asset Purchase Programme

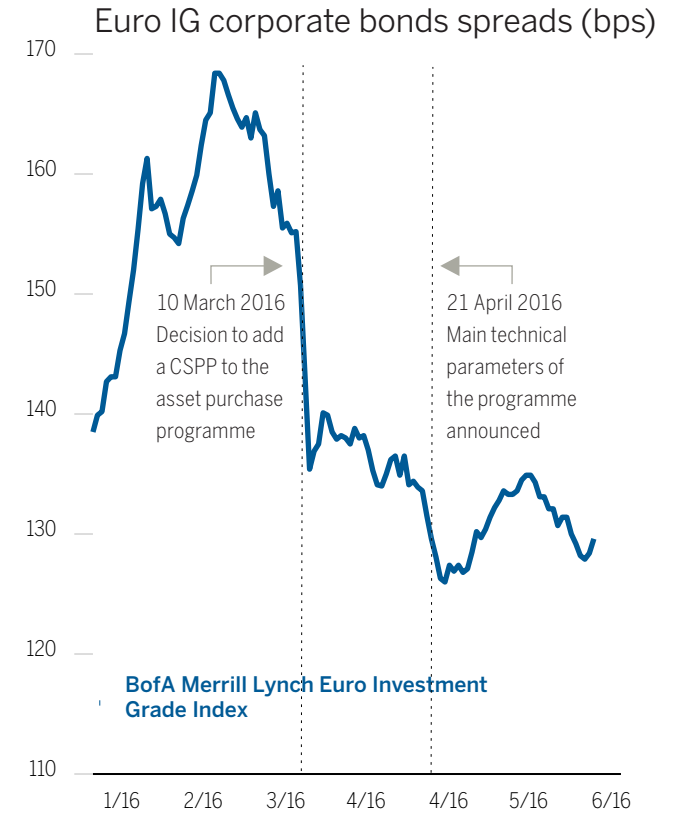
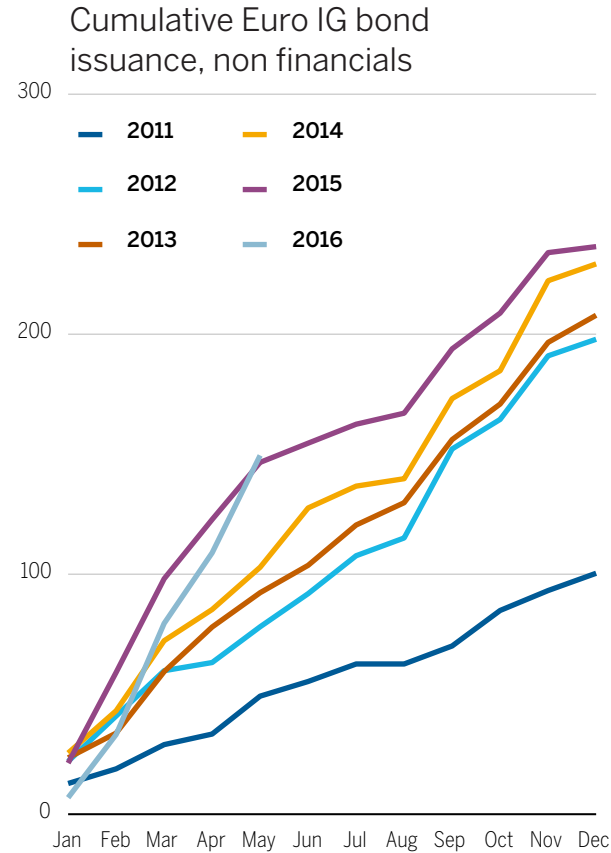
ECB balance sheet expansion continues...
... but what remains in the toolkit



Sources: Haver, ECB, BoE, Fed, BoJ

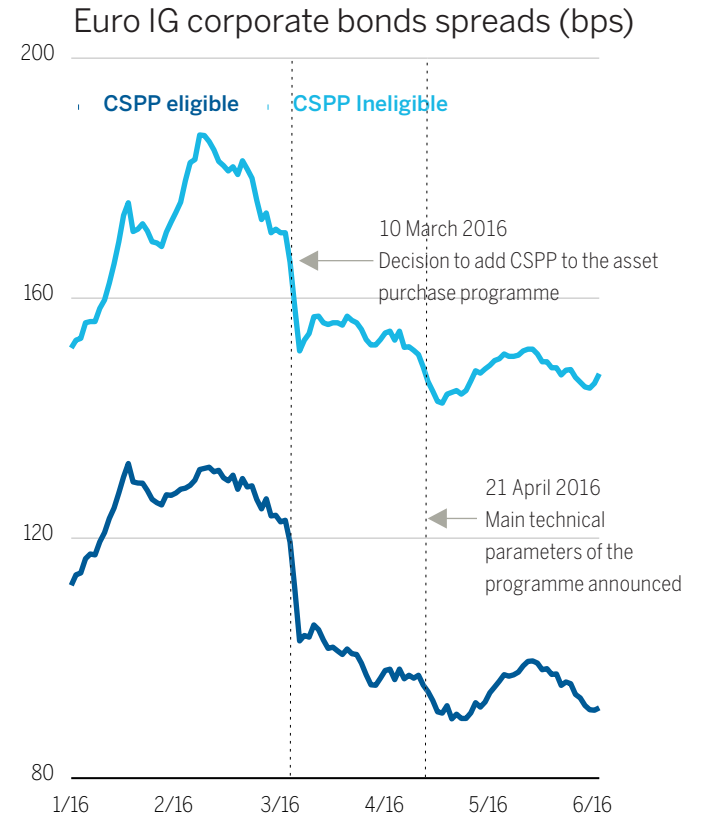
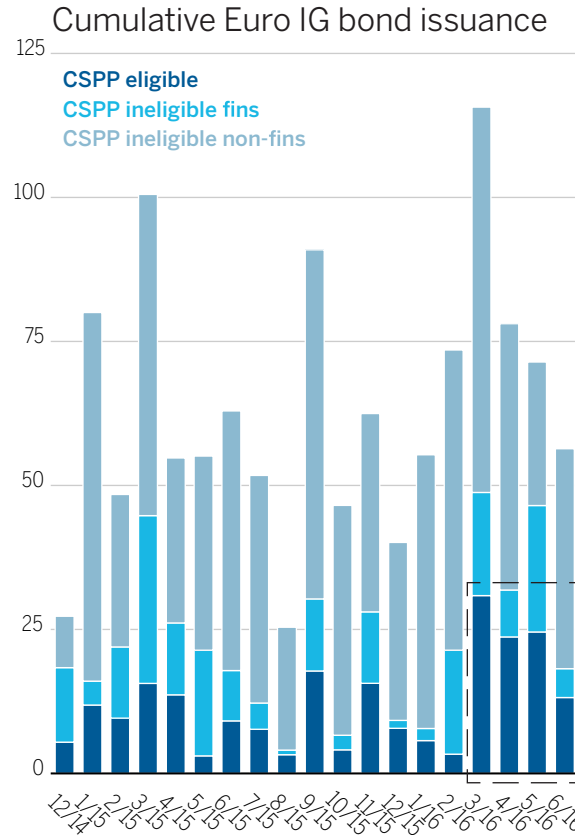
Asset Purchase Programme

Cumulative EUR issuance catching up with a record 2015 YTD...
...and spreads have tightened meaningfully since early March



Asset Purchase Programme

Bifurcation of issuance across eligible vs ineligible so far ...
...whilst spread compressions have been somewhat less discriminate



Sources: BofA Merrill Lynch, Dealogic, Danske Bank, Bloomberg

Thoughts and observations

An investor's perspective

1. Liquidity continues to be a challenge, we monitor this closely
2. Issuance is increasing
3. Corporate behavior
4. Investment opportunities
5. Brexit and its impact on Europe

For discussion

1. Central Bank toolkit: helicopter money and negative rates
2. Fiscal policy
3. Politics
4. China slowdown
5. Impact of low yields
6. Unwind of globalization

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