

ECB Preview

Questions about Greece, Greece and ... Greece

- **Greek situation** – questions about ECB lifting ELA cap and the possibility of reintroducing the waiver
- **Flexibility in ECB programmes** – limited pre-summer frontloading; the ECB can use ‘broad discretion’ in measures
- **Economic development** – nothing has changed since the forecasts in June
- **Market impact** – muted, unless Draghi becomes clearer on Greece-related ECB action

Focus at the ECB meeting will be on Greece and the ECB’s liquidity provisions to the fragile Greek banking sector

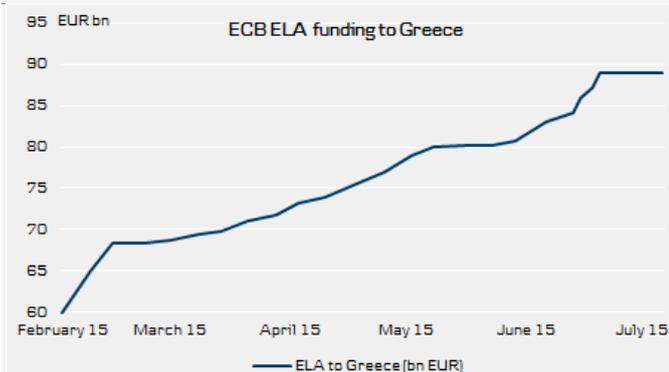
When the ECB members meet on Thursday 16 July the Greek parliament is expected to have passed the prior actions to the agreed economic reform measures late Wednesday evening as a further step towards obtaining a third ESM programme. Based on this, we expect the ECB to start gradually raising the cap on the ELA funding to Greek banks – a decision which could be announced during the press conference. Looking further ahead, when Greece is again under a programme, the ECB is expected to reintroduce the waiver, allowing Greece to use its government bonds as collateral in regular liquidity operations, see *Grexit – what if? Greece kept on a short leash*, 13 July 2015. We expect, however, that the ESM programme has to be in place for this to happen, and the Greek banks are dependent on the ELA until ESM negotiations are complete. Head of the Eurogroup Jeroen Dijsselbloem has suggested that it could take up to four weeks.

Although the risk of Grexit is reduced substantially with the latest ‘conditional deal’, the ECB is likely to be asked how it could continue to provide ELA funding to the Greek banks after the Greek population voted ‘No’ in the referendum, as this reduced the ‘credible prospect of agreement’. This question will be in line with some of the hawkish members’ stance as, for example, the Bundesbank’s Jens Weidmann argued in favour of closing the ELA funding to the Greek banks weeks ago. We expect that ECB President Mario Draghi, on the other hand, will reiterate his answer from the latest *press conference* that ‘*We are a rule-based institution. Our ELA is devised and designed to supply credit to the private sector, not to finance the government. These rules are being applied and they are being regularly reassessed as developments in the financial markets unfold.*’

Senior Analyst
Pernille Bomholdt Henneberg
+45 30 51 53 75
perni@uk.danskebank.com

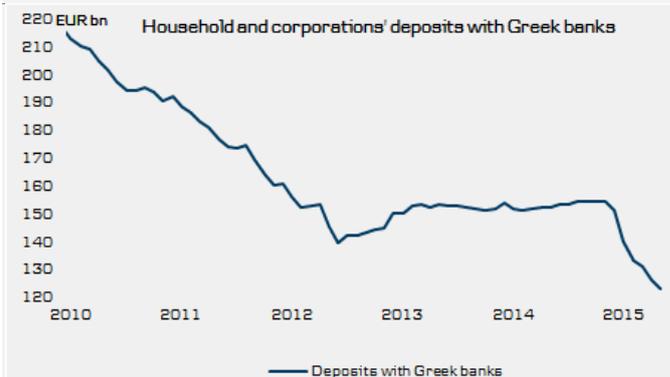
Senior Analyst
Anders Vestergård Fischer
+45 45 14 69 96
afis@danskebank.dk

The ECB set to lift ELA funds when 'prior actions' are approved



Source: Bloomberg, ECB, Danske Bank Markets

The deposit withdrawal limit will not be removed soon



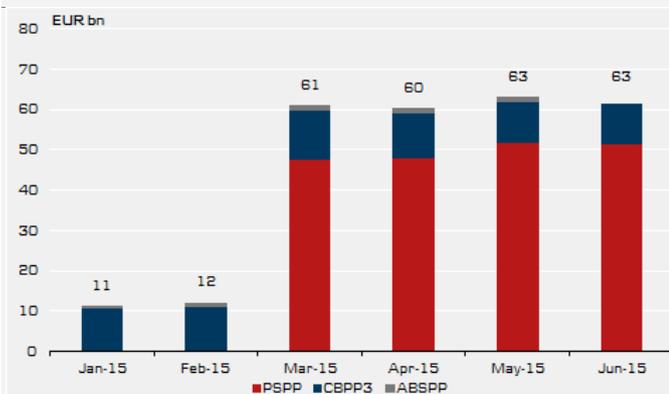
Source: Bloomberg, ECB, Danske Bank Markets

The ECB is ready to act in relation to the Greek situation, but for now soft words have been enough

When the Greek government called for a referendum on the Institutions' proposals, the ECB sent out a statement signalling its readiness to act if the Greek situation had implications for the monetary policy stance, see [statement](#). Overall, the uncertainty concerning Greece has had a general muted market impact, and so far soft words from the ECB have been enough even though the ECB statement could have been more explicit, see [Grexit – What if? Greek referendum changes the game](#), 29 June 2015. The ECB did thus not use the opportunity to step up QE purchases under the previously announced pre-summer frontloading. In both May and June the ECB purchased EUR63bn assets, which is a very moderate increase compared to the previously announced monthly purchases of EUR60bn, see [QE Details: Minimal QE frontloading and longer maturity in Spain](#), 5 July 2015.

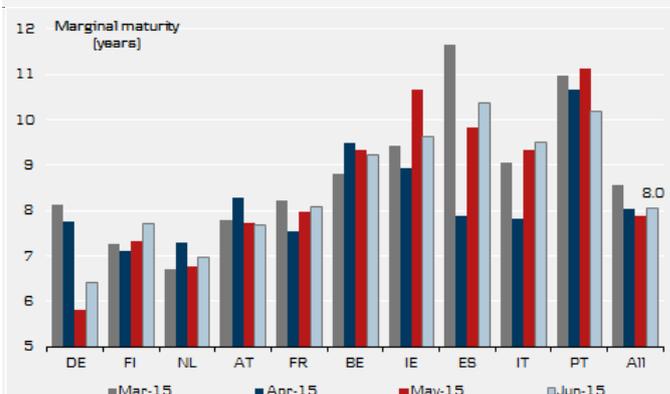
Nevertheless, the ECB has repeatedly stated that the QE programme has some embedded flexibility, which could be used if Greek contagion intensifies. Added to this, two of the ECB executive board members have mentioned the European Court of Justice's judgment that the ECB has 'broad discretion' in its open market operations (see Peter Praet's [speech](#) and Benoit Cœuré's [interview](#)). This suggests that the ECB could change the OMT conditionalities if needed.

ECB frontloading was limited in both May and June



Source: Bloomberg, ECB, Danske Bank Markets

Higher purchases in Italy and Spain in June confirm flexibility



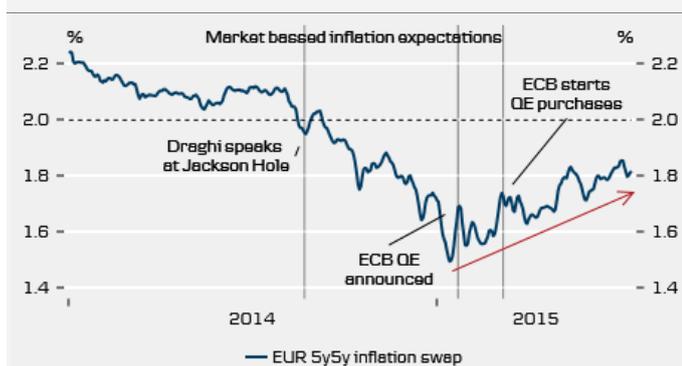
Source: Bloomberg, ECB, Danske Bank Markets

The economic development has been in line with the ECB's June projections

At the most recent ECB meeting in June, Draghi argued that *'the monetary policy measures have contributed to a broad-based easing in financial conditions, a recovery in inflation expectations and more favourable borrowing conditions for firms and households'*. The lending figures together with the Bank Lending Survey for Q2 confirm that the latter is still in place. We also expect that the ECB will remain satisfied with the recovery in inflation expectations, even though it is modest and was negatively affected by the latest decline in the oil price. Finally, Draghi does not seem to be concerned about the sell-off in fixed income markets, as at the meeting in June he said *'certainly one lesson is that we should get used to periods of higher volatility'*.

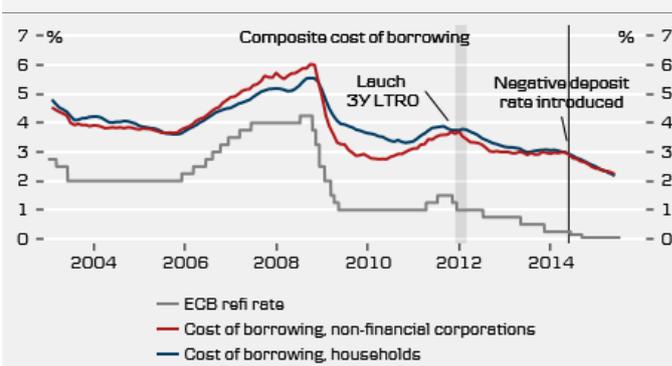
Together with the latest activity and inflation data, this should imply that the ECB maintains its view on the economic outlook. This also follows, as the Greek uncertainty has so far not impaired investor and consumer confidence. Based on this, the ECB should continue to conclude, *'The full implementation of all our monetary policy measures will provide the necessary support to the euro area economy, lead to a sustained return of inflation rates towards levels below, but close to, 2% in the medium term, and underpin the firm anchoring of medium to long-term inflation expectations'*.

Market based inflation expectations continue gradually higher



Source: Bloomberg, ECB, Danske Bank Markets

Borrowing conditions for firms and households have improved

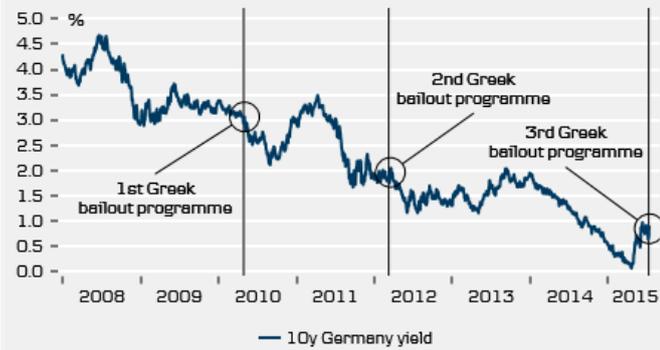


Source: Bloomberg, ECB, Danske Bank Markets

Market impact likely to be very limited unless Draghi reveals details on the ECB toolbox

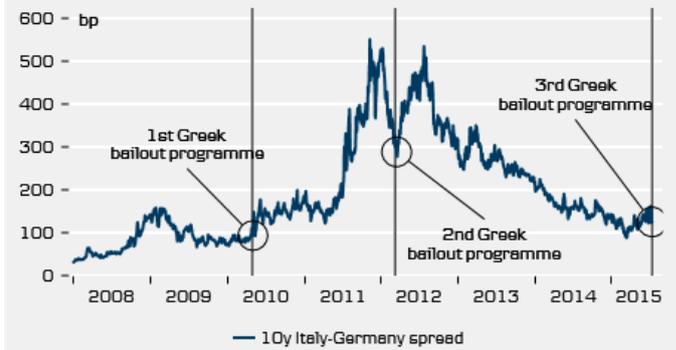
As we expect both policy and communication about the policy outlook to be unchanged (full implementation of QE needed) as well as most questions to focus on Greece, we believe the market impact of Thursday's ECB meeting is likely to be very limited. Ten-year Bund yields and periphery spreads are currently around the same level as before the Greek referendum was called on 26 June and, although Greek newsflow has moved the markets over the past three weeks in particular, movements have been significantly less than around previous Greek bail-out negotiations (see charts). Thus, we think it will require Mario Draghi to reveal new details on the ECB emergency toolbox to move the markets significantly and this does not seem likely, with markets welcoming the deal on Monday and after it (once again) proved sufficient for the ECB to do nothing but state its readiness to act.

10Y Bund yields around the level before the Greek referendum



Source: Bloomberg, ECB, Danske Bank Markets

The same holds for periphery spreads



Source: Bloomberg, ECB, Danske Bank Markets

Disclosure

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of this research report are Pernille Bomholdt Nielsen, Senior Analyst and Anders Vestergård Fischer, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in this research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

The research reports of Danske Bank are prepared in accordance with the Danish Society of Financial Analysts' rules of ethics and the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from and do not report to other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not

undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

Disclaimer related to distribution in the United States

This research report is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.