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Natixis Asset Management' experts comment the ECB meeting – held on June 5, 2014

Philippe Waechter, Chief Economist - Natixis Asset Management

The ECB changes the scale of its operations

The ECB has announced measures to stabilize the money market and measures which will bring more liquidity at a longer horizon in order to boost credit growth and a more sustainable growth recovery. This will keep interest rates at a very low-level for an extended period, at least until the end of 2016. This will have a long-lasting downward effect on the interest rates structure, peripheral countries included. Even with a negative deposit facility rate, I don't think that the euro exchange rate will drop. The current account surplus of the Euro Area is large and here to stay. That will maintain a strong euro exchangerate. Targeted operations on credit will transfer credit risks from the banking system to the ECB. But this transfer will be temporary. The length of the operation is limited to four years. This could be a boost for the development of credit but there are still uncertainties on the banks' willingness to renew a kind of operation that was put in place at the end of 2011 and beginning of 2012. As I mentioned in an earlier post (here), will it be sufficient to exit from a risk of deflation? That's the question because the inflation rate will not converge to its target before 2017 – 2020. It's still far in the future.

More comments about measures taken by the ECB on Phillipe's Waechter Blog:

Philippewaechter.en.nam.natixis.com

Yves Maillot, head of Europe Equity, Natixis Asset Management

Draghi talked today – Buy the rumour, sell the news... or not ? and will it be enough ?

Almost two years after his “whatever it takes” speech moment, Mario Draghi and the ECB have announced a number of policy easing measures .This looks like a front loading exercise – rate cut, cLTRO, full allotment of liquidity extended until december and dropping the sterilization of the SMP . All these measures were on the table as possible policy tools over the course of the next few months but in choosing to use each today, Draghi and the ECB have clearly tried to shock markets positively. And it has been well received today as an immediate reaction on the equity markets. Will it last ?

a/ the measures announced :

- 1. Rate cuts:** The ECB became the first major central bank to cut deposit rates to negative (-10 bps). It also cut the main refinancing rate by 10 bps to 15 bps.
- 2. An easing package beyond market expectation:**
 - Launched “TLTROs” (**targeted LTROs**): up to 7% of loan books to non-financial corporates (approx. €400bn). This is bigger than the ~5% of loans expected by the market;
 - **Full allotment of liquidity** fixing to banks extended until at least Dec16, this is beyond most expectations of Jun15;

- **SMP** (Securities Markets Programme, i.e, purchases of peripheral bonds in the crisis period) will no longer be sterilised – the additional liquidity will no longer be taken out of the market.

3. **“And a hint of QE”:** Mr Draghi mentioned intensified preparatory work on an ABS purchase programme, and left the door open for more easing measures. Furthermore, he responded by “we are not finished” when asked about potential for QE if required.

b/ the immediate market reactions :

European equities rallied in the immediate reaction with Euro STOXX 50 up on the day and DAX testing 10,000 for the first time, at one point.

Currency : Euro tested 1.36 vs. the Dollar (a support level over recent days).

Fixed Income markets : Peripheral government bonds led in the rally with 10 year Italy, Spain and Portugal government bond yields down by almost 5-7 bps. The core yield curve steepened with the front-end heavily pinned down by the easing measures and a negative deposit rate, while 10y bunds initially sold off.

(My) conclusion: Good for the markets and not enough for the ‘real’ economy

1. At first sight, the measures announced are going in the good direction for equities (we have a more specific watch on the banking sector), for long bonds and for a weaker euro.
2. However, all the measures had been expected (but maybe not all today).

Questions coming as impact on the banking companies :

- about how will an asset purchase scheme operate and how this will operationaly work ahead of the AQR / banks stress tests ?
- (still on the banking sector) the LTRO (up to €400 billion) is conditional on expanding the loan book to the non-financial private sector – more likely the core banks will take more advantage than the Periphery.

3. And above all, questions remain on the macro impact as for later impact on European profit ?

Draghi said impact on real economy may ‘take 3 to 4 quarters’ to show up. That suggests they are in no hurry to move to QE. This also shows and confirms that the Europe macro outlook is weak (ECB staff forecasts cut 2014 GDP and inflation forecast today) and does not give more confidence on corporate earnings.

Olivier de Larouziere, Managing Director & Head of Interest Rates, Natixis Asset Management

Recap

Although the scope of the above measures exceeded most market participants' expectations, including Natixis AM, the market reaction has been muted so far, perhaps as investors await US employment figures. The ECB has sent the resounding message that it will continue to take the necessary measures to combat low inflation and deflation in certain Euro-zone countries. In addition to lowering rates across the board, the bank committed to making EUR 400 billion in cheap loans on the condition that banks lend more to the private sector. The ECB also indicated it would intensify its preparation to embark on quantitative easing measures, purchasing asset-backed securities at a date to be announced.

Implications for interest rate strategies

Over the past few months, NAM's interest rate forecasts have pointed to lower rates and thus lower spreads, despite the fact that consensus data and market sentiment maintained persistent expectations for higher rates, perhaps linked to higher US rate expectations. However, our central scenario has centered around continued low yields, and our in-house model recently pointed to 1.32% as fair value for the 10 year German Bund, a level which the market subsequently reached in recent weeks. Throughout this period, our interest rate strategies have privileged neutral to long durations, a view that has been rewarded since the start of the year but which has only recently gained traction in the market place. Indeed, leading up to the ECB announcement, we have observed a decisive shift in investor positioning to long duration; the last time this kind of market reversal happened was in 2012.

In light of yesterday's news, and contrary to broader market positioning, we remain more defensive than the consensus and prefer a neutral duration posture, because our reading of the BCE announcement implies a bearish risk for bonds as well. Our interpretation is that the ECB has sent a strong statement to investors that they will do "whatever it takes" to extract the Euro-zone from anemic inflation or deflation in certain countries. The effect on ten year yields should send them back into the lower end of our 2014 target range of 1.50%-2.25% for the 10-year German bund. As such, this combination of an extremely bullish market on the back of ECB messages represents an opportunity to reduce duration exposure in our portfolios as rates should drift higher into the above range. Toward the end of 2014, we could touch the higher end of this range as US yields should reflect anticipations for 2015 FOMC tightening.

Perhaps the most beneficial measure is the four-year, EUR 400 billion Targeted Long Term Refinancing Operation (TLTRO) to be implemented in September and December 2014. This move targets in particular the real economy but should benefit peripheral European countries such as Spain and Italy, where we already hold strong overweights. We thus maintain these positions in both countries.

Finally, we view the implications for inflation-linked strategies as encouraging. The ECB has in effect revised inflation expectations downward to 0.7% for 2014 and 1.1% for 2015, and suspended the sterilization program which it had been unable to implement. Any downgrade in inflation figures will push the ECB to take unconventional measures including broad-based asset purchases (QE) that will provide support for inflation-linked bonds. Given these factors, current market inflation expectations of 0.8% for three years and 1.45% for ten years are attractive in our view and justify a continued overweight or off-benchmark allocation to inflation-linked bonds in our government and aggregate portfolios.

About Natixis Global Asset Management

Natixis Global Asset Management is one of the 15 largest asset managers in the world based on assets under management.¹ Its affiliated asset management companies provide investment products that seek to enhance and protect the wealth and retirement assets of both institutional and individual investor clients. Its proprietary distribution network helps package and deliver its affiliates' products around the world. Natixis Global Asset Management brings together the expertise of multiple specialised investment managers based in Europe, the United States and Asia to offer a wide spectrum of equity, fixed-income and alternative investment strategies.

Headquartered in Paris and Boston, Natixis Global Asset Management has assets under management totaling €652.9 billion (\$899.9 billion) as of 31 March 2014². Natixis Global Asset Management is part of Natixis. Listed on the Paris Stock Exchange, Natixis is a subsidiary of BPCE, the second-largest banking group in France. Natixis Global Asset Management affiliated investment management firms and distribution and service groups include Absolute Asia Asset Management; AEW Capital Management; AEW Europe; AlphaSimplex Group; Aurora Investment Management; Capital Growth Management; Caspian Private Equity; Darius Capital Partners; Gateway Investment Advisers; H2O Asset Management; Hansberger Global Investors; Harris Associates; IDFC Asset Management Company; Loomis, Sayles & Company; McDonnell Investment Management; Mirova; Natixis Asset Management; Ossiam; Reich & Tang Asset Management; Snyder Capital Management; Vaughan Nelson Investment Management; Vega Investment Managers; and Natixis Global Asset Management Private Equity, which includes Seventure Partners, Naxicap Partners, Alliance Entreprendre, Euro Private Equity, Caspian Private Equity and Eagle Asia Partners.

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¹ Natixis Global Asset Management (NGAM) is the world's 15th-largest asset manager based on global assets under management as of December 31, 2012, according to Cerulli Associates.² Assets under management (AUM) may include assets for which non-regulatory AUM services are provided. Non-regulatory AUM includes assets which do not fall within the SEC's definition of 'regulatory AUM' in Form ADV, Part 1.

About Natixis Asset Management

With assets under management of €294 billion and 633 employees, Natixis Asset Management ranks among the leading European asset managers. Natixis Asset Management offers its clients (institutional investors, companies, private banks, retail banks and other distribution networks) tailored, innovative and efficient solutions organised into 6 investment divisions: Fixed income, European equities, Investment and client solutions, Structured and volatility developed by Seeyond,¹ Global emerging, and Responsible investing developed by Mirova².

Source: Natixis Asset Management – March 31, 2014. ¹ Seeyond is a brand of Natixis Asset Management. ² Mirova is a wholly owned subsidiary of Natixis Asset Management.