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# Let the ECB pay you

Evan Lorenz writes:

Now that the world's central banks have cornered the bund market (they hold 90%, it was related in these pages two weeks ago), where is the European Central Bank going to find enough German paper to satisfy its still wolfish appetite? Simple: in Germany. The stewards of the euro are adding seven state-owned German banks to the quantitative-easing program.

If all goes according to plan, the ECB will end these ad hoc addendums when the bank's QE program stops later this year. Since wholesale asset-buying began in March 2015, the balance sheet of the Bank of Draghi has more than doubled. This makes the ECB's $5.6 trillion of footings larger than the Federal Reserve's $4.4 trillion, even though the $19.4 trillion U.S. GDP handily tops the $12.5 trillion GDP of the 19-member eurozone.

While Draghi may have pinned price discovery to the mat for now, he has not conquered the business cycle. Gun-shy after ill-timed rate hikes in 2008 and 2011 that stunted rather than stimulated euro-area output, the ECB has promised never again to raise its intervention rate, now set at negative 0.4%, until "well past the horizon of our net asset purchases." This sets up the real possibility that the central bank will enter the next bust with negative rates.

While there are no signs of recession in today's tea leaves, it does appear that the eurozone's formerly strong pace of growth is slowing. On Tuesday, IHS Markit announced that the eurozone manufacturing PMI dropped to 56.6 in March, an eight month low, from 58.6 in February. Driving that decline is a slump in sentiment, which fell to a 15-month low. Softer economic readings have sent the Citi Economic Surprise Index for the eurozone to negative 60.3 from positive 92.9 in November 2017.

The March 2020 three-month euro interbank offered rate (Euribor) contract is priced at 99.88, implying a future rate of positive 0.12% versus negative 0.33% today. Let's assume that euro-area activity slips in the next two years and the ECB does not, in fact, hike rates. If three-month Euribor remains unchanged, the 100.125 strike call options on the March 2020 contract would result in a net gain of 183%. If the ECB, facing a dearth of bonds to buy at a moment of economic weakness, had to push rates further into negative territory, the call options could result in even higher—and, surely, for the long-suffering victims of financial repression, sweeter—payouts.

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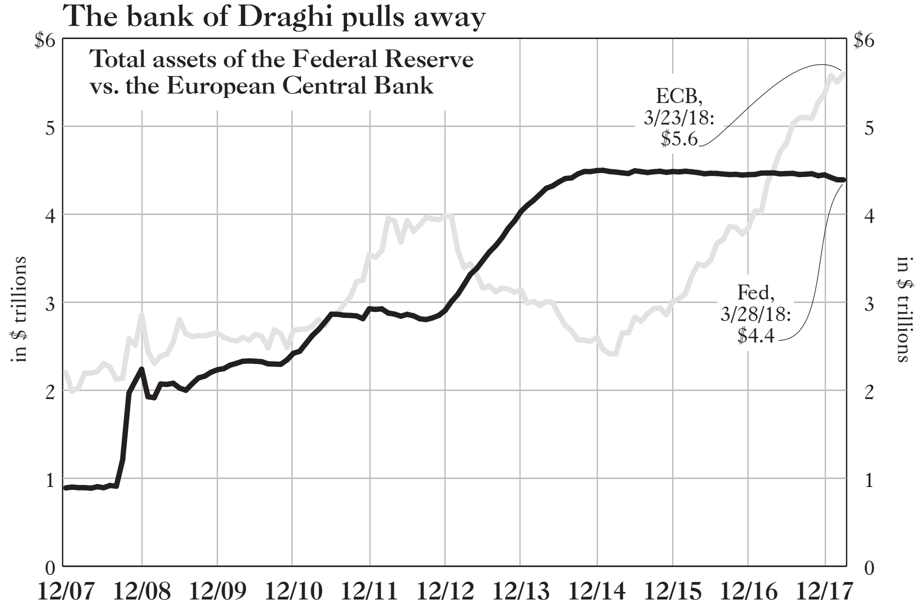
The bank of Draghi pulls away




source: The Bloomberg