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- €1.1 trillion total.
- €60 billion a month for 18 months.
- 80% of potential losses to be borne by national banks.
- 20% of potential losses to be borne by ECB.
- Option to extend based on 2% inflation target.

If size matters then Mario Draghi may just about have delivered. The €1.1 trillion quantitative easing programme announced on 22nd January is bigger than markets had hoped for given the opposition he faced from the German Bundesbank and a large number of the German and Dutch hawks on the Governing Council. But in absolute terms €1.1 trillion over 18 months is less than half what the Bank of England undertook with their own QE programme. Furthermore, it is unlikely to deliver as big a bang for their buck because it has come so late in the game when the eurozone has already fallen into deflation and facing the prospect of a triple-dip recession.

The delay is unsurprising given the amount of open hostility faced from the wealthier northern eurozone

nations. As we wrote in Q4, the collapse in eurozone inflation, combined with worsening employment and slowing economic growth is actually what Draghi needed in order to overcome Bundesbank opposition and give him the ammunition to finally pull the trigger. The timing appears to have worked. Even Angela Merkel avoided making direct criticism of the ECB in her speech at Davos saying “I think it is important we are not tempted to buy time and avoid doing structural change” which was more of a thinly veiled swipe at the heavily indebted Mediterranean states who stand to benefit most from a lower cost of borrowing that QE creates and, in the case of Greece, agitating for further concessions on repayment terms.

Other northern European politicians were rather more outspoken. The Dutch VVD party (predominantly Eurosceptic centre right coalition) said “Dutch taxpayers should not be made liable for the debts of the Italian state”. German newspapers also opened up overnight with varying levels of outrage that QE, and the risk sharing that comes with it, opens the way to eurobonds by the back door and, in doing so, let’s off the bailed out states off the hook for years of excess.

We believe that the size of the QE is as much as Draghi thought he, and the Latin bloc that supported him in the Governing Council, could get away with. However, despite the decision having been brought about by a majority vote, there are some important caveats relating to who actually wears any potential losses. As a nod to German concerns, 80% of the asset purchases will sit with the national central banks themselves and only 20% with the ECB. This isn’t a very satisfactory outcome for instead of keeping both sides happy, it feels more like the worst of both world’s for the 80% on national bank books opens up the door to a fragmentation of responsibility within a currency union, whilst the 20% looks, to the eurozone creditor core, like the thin end of a very expensive and morally wrong wedge.

But stock and bond markets reacted positively to the €60 billion a month cash injection which will run for 18 months until September 2016. German equities are up around 4% since the announcement with the Euro weakening 1.5% against the US dollar and reaching the lowest level against Sterling for seven years at €1.33. The 10-year Spanish Government bond yield, which moves inversely to bond prices, hit a record low of 1.46%.

The reaction is not just about the headline size of the QE programme. Crucially, Draghi has left the door open to extending the plan in September 2016 if inflation is not running at a pace consistent with the ECB’s 2% inflation target. This is an interesting notion given that much larger QE programmes in the USA, UK and Japan have not succeeded in getting any of their central banks inflation figures up to a similar level.

Of course, there are other deflationary factors at work but QE is not the great panacea for all the ills of the global economy. The transfer mechanism to translate newly printed money into stimulus that results in growth and inflation also requires a pick-up in corporate and household borrowing. And that means confidence. Confidence for companies and consumers to borrow and spend, and confidence of banks to lend to them in the first place. It is here that the TAM investment team will be looking for an indication that QE will ultimately work and not just in Europe, but in the other major developed economies where this remarkable financial experiment has taken place.

In conclusion, we believe that there is a longer term benefit to investing in Europe which

goes beyond the recent headlines and the announcement of QE. The transfer mechanism to stimulus is not always fully appreciated and we believe that current programme will ultimately displace funds out of low risk assets and into equities. We will retain our existing positions in Europe including those that we have recently added to on a hedged basis to protect against a falling Euro currency.

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