ECB LTRO Mk II. QE(Stealth)

The ECB’s QE(stealth) has worked a treat since the printing presses were deployed 22 Dec 2011. The 3 year repo saw a 489 billion Euro allotment, equal to over 620 billion USD.

The signs that the market’s analysts would get this one wrong, they had expected a maximum allotment of circa 250m Euro were clear. The weekly allotments prior to 22 Dec were snowballing with the 14 Dec allotment totaling 291m Euro. That should have been the minimum forecast. A better estimate would have been 433m given the maturities of the 14 Dec 291m and the 21 Dec 142m.

On 29 Feb 2012, the ECB has another shot of morphine in the form of yet another 3 year repo. The size of the allotment is the multi-billion Euro question. Having got the allotment size forecast wrong first time round, the market is looking for double or triple the 489 billion Euro. They may not get it. The 1 week repos are not snowballing as quickly and at last count we can see 150m Euros. Of course between now and the end of the month things may change and the Open Market Operations of the ECB have to be monitored. This is just the latest tally as at 8 Feb.

My bullish call on equities, particularly European equities, since 14 Dec 2011, has been predicated on the ECB’s QE(stealth). The massive size of the 3 year repo on 22 Dec 2011 provided confirmation to the view and it has been a view that has worked out. This all does not imply that the European or Global economy has recovered or is in recovery. Far from it. Instead, it has been a market call based on psychology and an understanding of human emotional frailties.

My market view is therefore sensitive to the 29 Feb LTRO. The market is pricing in a large allotment, in the region of 250m to 500m Euro. Some forecasts range as far as a trillion Euro. If the banks and the ECB disappoint, it would certainly invalidate or weaken the thesis.

One part of the thesis remains, that bank funding stress has been unequivocally relieved. This alone should have some support for risky assets in Europe.

The outlook therefore is now quite uncertain. I would remain long and cautious, monitoring the 1 week repos for signs that the banks are hoarding collateral for the 29 Feb LTRO. If the number threatens to be big, I would add risk and if the number looked to be missing its target, I would reduce risk. These are the signposts.

From a fundamental perspective, the economies of Greece, Portugal, Ireland, Italy and Spain operate at productivity levels inconsistent with factor prices prevailing in the market. Some of these rigidities stem from the use of a common currency, the Euro. You cannot leverage a fundamentally flawed business model (or economy) into viability. The strategy above therefore is akin to a game of chicken.