

Macro Keys

Event risk in June

Global Macro Strategy

Global

An unusual number of known unknowns...

June 2016 is a month in which the number of event risks is particularly high. In our baseline scenarios we do not see market upsets, but the potential is there.

... from several sources

Japanese fiscal policy; meetings of the ECB, Fed and BoJ; new ECB policy implementation; a German Constitutional Court ruling; the UK referendum; elections in Spain; and a decision on the FTT are all thrown into the mix.

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June 2016 is a month in which the number of event risks is particularly high. In our baseline scenarios we do not see market upsets, but the potential is there – and from several different sources.

Figure 1: Selected events in June

| Date | Event |
|---------|---|
| 01 June | Closing day of the current session of the Japanese Diet |
| 02 June | ECB meeting and press conference |
| 10 June | ECB announces intended bank repayments of TLTRO I |
| 15 June | FOMC meeting and press conference |
| 16 June | BoJ meeting and press conference |
| 21 June | German Federal Constitutional Court ruling on ECB OMT programme |
| 24 June | Result of UK referendum on EU membership |
| 26 June | Spanish general election |
| 24 June | Results of first TLTRO II auction |
| 30 June | Due date for a decision on the European FTT |

Source: UBS

1 June: Closing day of the Japanese Diet – new fiscal action?

We expect Japanese Prime Minister Shinzo Abe [to announce new fiscal policy](#) on 1 June – the closing day of the current session of the Japanese Diet. We think that the scheduled rise in the consumption tax will be delayed and a supplementary budget of ¥5-10tn could be announced. It is also possible that the Lower House is dissolved and new elections called.

2 June-16 June: Central bank meetings

On balance, we do not expect any change in monetary policy to be announced by the ECB, the Federal Reserve or the BoJ in June, but statements and guidance will be watched closely.

First up is the ECB on 2 June. The ECB will present its new staff forecasts at the press conference. We think [the key challenge for Mr Draghi will be to not appear too hawkish](#) amid rising oil prices and robust Eurozone Q1 GDP growth, and we believe it too early for the ECB to send strong signals about the duration of QE beyond March of next year. But much will be discussed.

After that, the FOMC will meet on 15 June. We think that it will wait until September before it next raises rates (in part because of upcoming event risk). However, the minutes of the April meeting and recent Fed rhetoric has kept this meeting “live” and expectations higher than they might otherwise have been.

We don't think that the BoJ will announce a further easing on 16 June, but it will be a close call. [We see a 40% chance that it does, and a 60% chance that this takes place by July](#). If conducted in combination with a fiscal expansion (see above), Japan would in effect be conducting a policy of 'helicopter money' and we would expect the polemic to increase in global markets on this subject.

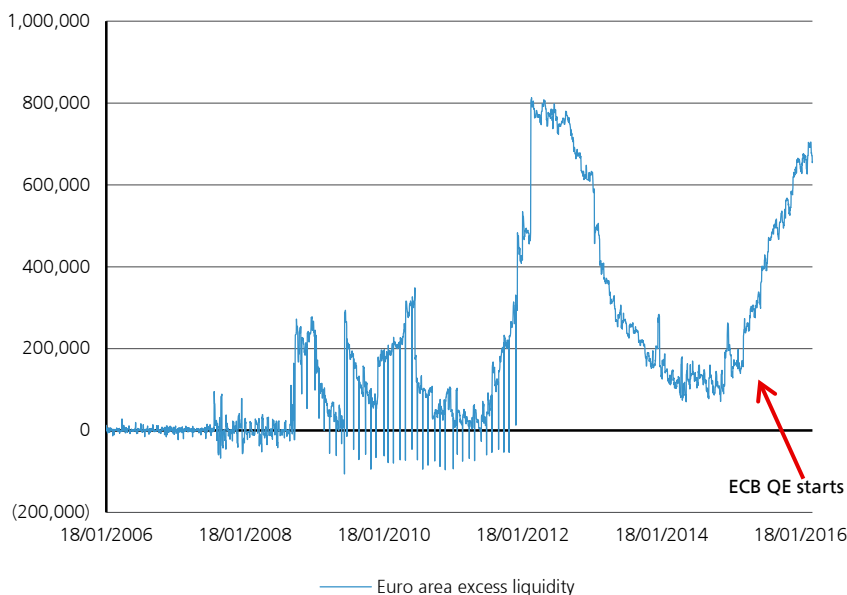
6-10 June / 24 June: TLTROs, and other ECB policy implementation

While we do not expect new ECB policy to be announced at the June meeting (see above), June is the month in which some already-announced policies are implemented for the first time. The first auction of the new Targeted Long-Term Refinancing Operations (TLTRO II) will take place on 23 June, with the publication of the results on 24 June. Market focus has been on the ability of banks to borrow 4-year money at an interest rate (to be set by ex-post calculations) as low as the current deposit rate of -0.40%.

However, we think that more important will be the first voluntary repayment of TLTRO I to be announced at 11.00am London time / 12.00pm CET on 10 June. (The repayment itself will take place on 29 June, coinciding with the first settlement date of TLTRO I). [It is likely that the bank repayment of TLTRO I will be larger than the take-up of TLTRO II](#) – and result in the first significant reduction of the ECB's balance sheet since QE began in March of last year. In turn, this might appear as an involuntary tightening of monetary policy.

The reason this might happen is that one of the effects of QE has been a large-scale creation of deposits in euro area banks. But TLTRO I took place before QE was announced and banks have been unable to repay it until now. Many of them – particularly in core countries – have been burdened with large excess liquidity as a result. In turn, this has meant a drag on Net Interest Margins (NIM) for these banks as risk free rates have been negative while they are (by and large) paying 0% to depositors.

Figure 2: Excess liquidity in the euro area financial system, past 10 years



Source: ECB, UBS

Also in June, we expect [the Eurosystem to begin its purchases of corporate bonds](#) in its Corporate Sector Purchase Programme (CSPP). It is likely that this will begin in the days shortly after the ECB's press conference on 2 June. The corporate bond market will be watching the implementation of purchases on a daily basis. We believe that once the CSPP settles in, the Eurosystem will be buying around €12bn

a month in corporate bonds. Last Wednesday Reuters reported that – citing “several bank sources” – these will amount to €5-10bn per month initially.¹

21 June: German Constitutional Court ruling on OMTs

On 21 June, the German Federal Constitutional Court in Karlsruhe will give its final ruling on the acceptability of the ECB’s Outright Monetary Transactions (OMTs) programme in the field of German law. In our view, this represents less of an immediate market risk than a contingent one. In a scenario where the Court ruled against OMTs, uncertainty might increase over the ability of the ECB to respond to another period of extreme volatility in European sovereign markets

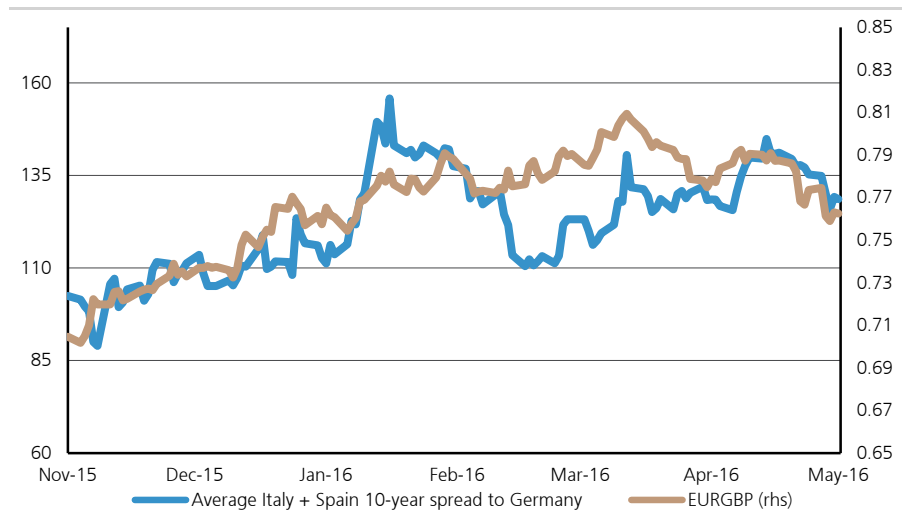
Some appear to think that a ruling against OMTs might impede the purchase of peripheral bonds in the ECB’s current QE programme. We believe this to be unlikely. Bundesbank opposition to QE as a monetary policy tool in principle (even if not in timing) seems slight.

It is widely accepted that the announcement of OMTs in the summer of 2012 was the beginning of the end of the sovereign debt crisis in Europe. But in October 2014, the German Constitutional Court found that the policy was “incompatible with primary law”. At the same time, the judges in Karlsruhe passed it on to the European Court of Justice for review, which last year came to the opposite conclusion (though in the context of European law).

24 June: Result of the UK referendum on EU membership

The recent rally in sterling and the tightening of peripheral sovereign spreads have been widely attributed in the media to an increase in confidence that the UK referendum will result in a vote to remain. If correct, this would mean that there would be [potential for sterling to fall](#) and [peripheral spreads to widen](#) once more in a scenario where there is either a vote to leave or if opinion polls showed increased support for that outcome.

Figure 3: Average Italy and Spain 10-year spread to Germany and EURGBP; past 6 months



Source: Bloomberg

¹ [Reuters: ECB credit buying to start small, betting on issue boom – sources, 25 May 2016](#)

26 June: Elections in Spain

Spain will hold another general election on 26 June, after its 21 December 2015 election resulted in no government being formed. In general, we think that Spanish yield spreads to Germany should tighten over the coming months as the relatively strong growth heals the economy and improves debt dynamics.

However, Spain missed on its deficit targets in 2015 by a wide margin and is likely to miss again this year, according to the European Commission. In part, this can be attributed to the dominance of elections in the public calendar. But there is a risk to sovereign spreads if a government is formed after the elections which might take an anti-austerity stance and widen the public deficit even more.

30 June: A decision on the European Financial Transaction Tax

A group of European governments have been proposing a European Financial Transaction Tax (FTT) for several years. In the most recent statement, the proponent governments indicated that *"taxation should be based on the principle of the widest possible base and low rates and it should not impact the cost of sovereign borrowing"*².

The statement also directs governments to decide on further details – including, importantly, the levels of the tax – by the end of June: *"in order to prepare the next step, experts in close coordination with the commission should elaborate adequate tax rates for the different variants. A decision on these open issues should be made until the end of June 2016."*

It should be noted, however, that aside from the 10 countries currently promoting the tax there is opposition among other EU member states, most notably the UK. Under the "Enhanced Cooperation" framework, the countries will pursue the policy only if 9 or more member states support it. In December, Estonia withdrew its support for the project.

² [Council of the European Union statement, 8 December 2015](#)

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