JREB: The Macro Case

JP Morgan ETFs (Ireland) ICAV

EUR Corporate Bond Research Enhanced Index (ESG) UCITS ETF

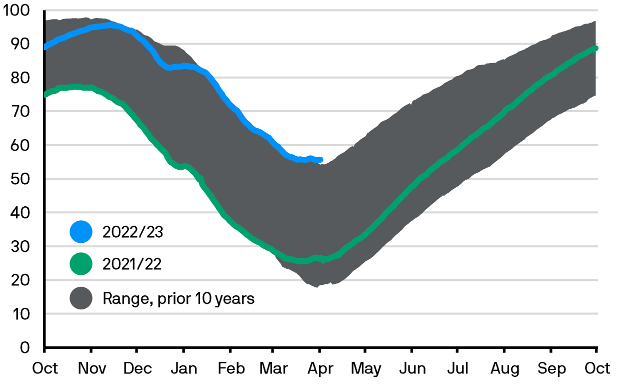
Risks of a deep recession have significantly reduced

At the start of Q4 2022, the economic outlook for Europe looked concerning with gas rationing a major worry. However, a combination of warm weather, reduced demand and US LNG imports helped Europe avoid a recession this past winter, and seasonally strong gas inventories mean the risk of rationing and a deep, painful downturn *next* winter is also much lower. Given this, sentiment has improved and PMI data remain resilient. Growth risks, while certainly reduced, do remain – higher interest rates will weigh on demand and lending conditions, already tightening, are likely to do so further. Gas prices have fallen but are still elevated and thus likely to pressure corporate earnings, Nonetheless, the outlook is much improved versus just a few months ago.

Source: Bloomberg, Gas Infrastructure Europe, J.P. Morgan Asset Management. Data as of 31 March 2023.

Exhibit 1: EU natural gas inventories

% of capacity



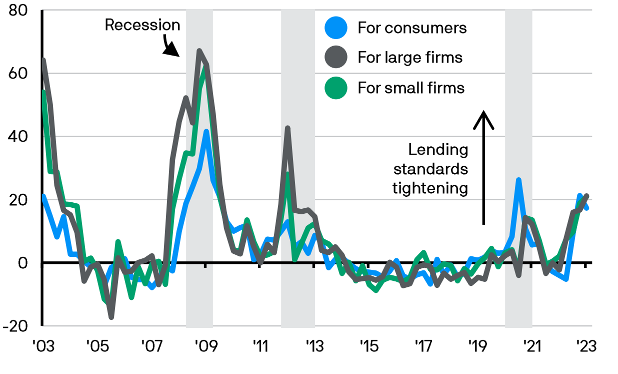
Tighter credit conditions warrant an up-in-quality approach

Credit conditions have already tightened as the ECB has increased interest rates, and they are likely to do so further given recent stress in the banking sector. Tighter lending standards could put upward pressure on credit spreads, suggesting that a focus on the higher quality parts of the European IG index may be desirable. The offset for fixed income investors is that an additional tightening in lending standards means the ECB likely has less left to do, especially as tighter financial conditions should help rein in inflation. Indeed, the expected terminal rate has now come down from its Q1 highs. The ultimate peak in yields may therefore be lower.

Source: European Central Bank, Refinitiv Datastream, J.P. Morgan Asset Management. Data is from the Euro Area Bank Lending Survey. Data as of 31 March 2023.

Exhibit 2: Eurozone credit conditions

% of banks tightening credit standards



Fundamentals are solid

European investment grade interest coverage sits at record levels, and still positive annual earnings growth has translated into modest deleveraging, with net leverage continuing to decline. Cash on balance sheets also remains near all-time highs. Despite these solid fundamentals, spreads sit above their long-run averages and are particularly appealing relative to the US. Recession risks have not gone away, but spread moves consistent with previous downturns are unlikely given European firms appear better prepared for tighter financial conditions than, for example, at the end of 2019. Indeed, many corporates have managed to lock in liquidity at the lower cost of previous years. The income-generating credentials of high-quality credit have also improved, which should be supportive for demand.

Source: Bloomberg Barclays, Refinitiv Datastream, J.P. Morgan Asset Management. Spread shown is for the Bloomberg Barclays Euro Aggregate – Corporate index. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

Exhibit 3: Euro investment-grade spreads

%, option-adjusted spread

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