

Market Bulletin

30 April 2020

The European Central Bank aims to ‘thread the needle’

The leader of the European Central Bank (ECB) has become very familiar with the challenge of ‘threading the needle’ in recent years and the test facing Christine Lagarde today was no different. After last month’s major announcements regarding the expansion of its quantitative easing program, the ECB announced few new meaningful measures today. It left its key interest rates unchanged and made no enhancements to its asset purchases. It did however decide to make borrowing conditions more favourable for euro area banks under its Targeted Longer Term Operations III (TLTROs) facility.

With an increasingly restricted toolkit to provide further stimulus, the ECB’s messaging had to be reassuring enough to avoid triggering market volatility and at the same time diplomatic enough to appease divergent views from across the euro area on the appropriate policy path. This task was only made harder by the downgrade of Italy’s sovereign bond rating by Fitch to one level above junk status and the large contraction in eurozone GDP for the first quarter of this year (-3.8% quarter on quarter).

Few new policy changes

With its deposit rate already at -50 basis points, the ECB’s decision to not reduce interest rates so far this year suggests a strong reluctance to go even lower. However, the ECB is not alone in seeing limited value in pushing rates further into negative territory. The Federal Reserve in its own meeting yesterday dismissed the idea that it would consider negative interest rates. The ECB is instead focusing on other tools as its main policy levers.

Borrowing costs for the TLTRO III programme were lowered to -1%, a further 25 basis points lower from last month’s meeting. The recent ECB bank lending survey showed a material increase in demand for loans across the euro area as corporates search for funds to get them through this period. In the near term, another series of short-term refinancing operations were also made available, likely as a safety net over the coming months. These are helpful measures but the magnitude of bond purchases is likely to be more important in supporting government spending to help mitigate the impact on the economy.

AUTHORS



Jai Malhi
Global Market Strategist

What are the other options?

With markets focused on debt sustainability, particularly in countries such as Italy, the ECB will need to focus on expanding its asset purchase programmes. It could do so by ramping up purchase amounts under the Pandemic Emergency Purchase Programme (PEPP). In the press conference Lagarde suggested that PEPP is the preferred tool as opposed to Outright Monetary Transactions (OMT), previously used in the sovereign debt crisis, given this is a euro area wide issue. An extension of PEPP beyond the end of this year, dependent on the duration of the virus was also highlighted as an option.

Having already announced that it would accept recently downgraded high yield bonds - so called 'fallen angels' - as collateral for banks' loans and made Greek bonds eligible for the PEPP, the ECB could also widen the scope of the asset purchases to include high yield bonds. Lagarde stopped short of explicitly confirming the forthcoming implementation of these measures, but stated that the flexibility of the ECB's mandate can be increased if required.

Ultimately, it is clear that the ECB will need to increase stimulus measures this year to ensure that the wave of bond supply required to fund government stimulus packages is smoothly digested by the market. At this meeting, Lagarde preferred to take a "wait and see approach" in the hope that coordinated government action will shoulder some of the burden and lift some of the pressure on the central bank to save the day.

Investment implications

Trying to find the perfect balance of policy announcement and forward guidance was always a tough challenge and markets appear to have reacted negatively to the measures announced today. The euro has fallen around 0.3% versus the dollar and European equities are also down on the day. The spread of Italian 10-year yields over Germany has been volatile and has broadly risen. With expectations from the ECB that eurozone GDP could fall by 5% - 12% in 2020, calls for further central bank action look set to get louder over the coming months.

The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions.

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide.

To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at <https://am.jpmorgan.com/global/privacy>.

This communication is issued by the following entities:

In the United States, by J.P. Morgan Investment Management Inc. or J.P. Morgan Alternative Asset Management, Inc., both regulated by the Securities and Exchange Commission; in Latin America, for intended recipients' use only, by local J.P. Morgan entities, as the case may be.; in Canada, for institutional clients' use only, by JPMorgan Asset Management (Canada) Inc., which is a registered Portfolio Manager and Exempt Market Dealer in all Canadian provinces and territories except the Yukon and is also registered as an Investment Fund Manager in British Columbia, Ontario, Quebec and Newfoundland and Labrador. In the United Kingdom, by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions, by JPMorgan Asset Management (Europe) S.à r.l. In Asia Pacific ("APAC"), by the following issuing entities and in the respective jurisdictions in which they are primarily regulated: JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, each of which is regulated by the Securities and Futures Commission of Hong Kong; JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), which this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; JPMorgan Asset Management (Taiwan) Limited; JPMorgan Asset Management (Japan) Limited, which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia, to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Commonwealth), by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919). For all other markets in APAC, to intended recipients only.

Copyright 2020 JPMorgan Chase & Co. All rights reserved.

0903c02a828a8a20