# Market Bulletin

4 June 2020

## The European Central Bank levels up its stimulus efforts

Today's actions from the European Central Bank (ECB) were at the upper end of market expectations. It increased the size of its Pandemic Emergency Purchase Programme (PEPP) by EUR 600 billion and the horizon of these purchases was pushed out to the middle of next year. It also committed to maintain the size of its PEPP holdings until at least the end of 2022. All other key policy tools were left unchanged, including the key interest rates. The meaningful increase in the size and length of emergency purchases highlights the ECB's determination to strengthen the recovery. Up until today, the ECB's response to the shock caused by Covid-19 looked relatively modest in comparison to global counterparts, but the latest steps go a long way in closing this gap.

### Economic downturn will be severe

New macroeconomic projections show the ECB expects GDP to fall by -8.7% in 2020 – towards the lower end of its range of expectations. This highlights the simple truth that the eurozone is facing the largest economic decline in its history. Many economies have so far been able to cautiously lift lockdown measures without a significant increase in new cases, but it remains too early to say with confidence that the path ahead will be smooth. So far any improvement in the economic data has been moderate and the ECB still sees downside risks around their current 2020 GDP estimate. If a resurgence in the infection rate leads to a subsequent increase in containment measures, the central bank expects real GDP to fall by 12.6% this year.

The ECB forecasters expect inflation to fall to 0.3% in 2020 and for it to remain muted in 2021, only picking up to 1.3% in 2022 and still well below target. The more pessimistic scenario would see inflation at just 0.9% in 2022. This highlights the extent of the impact that virus containment measures will have on prices and the challenge the ECB faces in achieving its inflation goals.

**EXHIBIT 1: European Central Bank staff macroeconomic projections for the euro area**

| | Real GDP (y/y) | | | HICP inflation (y/y) | | |
|---|---|---|---|---|---|---|
| Meeting | 2020 | 2021 | 2022 | 2020 | 2021 | 2022 |
| Mar-20 | 0.8% | 1.3% | 1.4% | 1.1% | 1.4% | 1.6% |
| Jun-20 | -8.7% | 5.2% | 3.3% | 0.3% | 0.8% | 1.3% |
| Change | -9.5% | 3.9% | 1.9% | -0.8% | -0.6% | -0.3% |

Source: European Central Bank, J.P. Morgan Asset Management. Data as of 4 June 2020.

AUTHORS

Jai Malhi
*Global Market Strategist*

J.P.Morgan
Asset Management

## No longer the only game in town

The ECB has previously stated that monetary policy cannot be the only game in town, and has frequently called for support from euro area governments. Last week's proposal from the European Commission, where it outlined a EUR 750 billion recovery plan, goes a long way in answering those calls. Many suspected that progress on the fiscal front had reduced pressure on the central bank to act, and calls from the German courts for the ECB to justify its asset purchases could have acted as a further headwind to any extension. Today's announcement therefore is a clear statement of the ECB's commitment to the cause.

The European Commission's recovery plan would provide important funding for countries and sectors that face significant disruptions to economic activity due to Covid-19. While there are still hurdles ahead, most notably in reaching unanimous agreement on the form of the recovery fund, the European policy response has taken huge strides forward in recent weeks. The eurozone may well emerge from the Covid-19 recession more quickly than the US and the UK, and has made meaningful steps towards structural integration at the same time.

## Investment implications

Today's additional action shows the ECB stands side by side with European governments in helping Europe get back on its feet. With inflation still expected to remain below target in 2022, this will see ECB policy remain extremely accommodative for some time, even with the prospect of additional fiscal stimulus.

If infection rates remain under control and the recovery fund proposal is agreed, the combined policy action from the ECB and European Commission provides Europe with the opportunity to take the first steps towards recovery. The ECB's additional purchases will allow it to swallow up government bond issuance and should help to keep a lid on peripheral government bond spreads. The market reaction to the policy response was mixed. Italian 10-year government bond yields fell sharply post the announcement, although German Bund yields rose. Equity markets have been choppy, but it should be acknowledged that today's announcement came on the back of several very strong days for European benchmarks.

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J.P.Morgan
Asset Management