

GIAM Macro & Market Research - Market Commentary

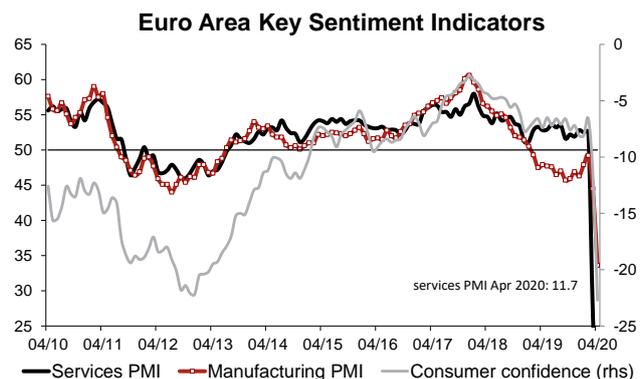
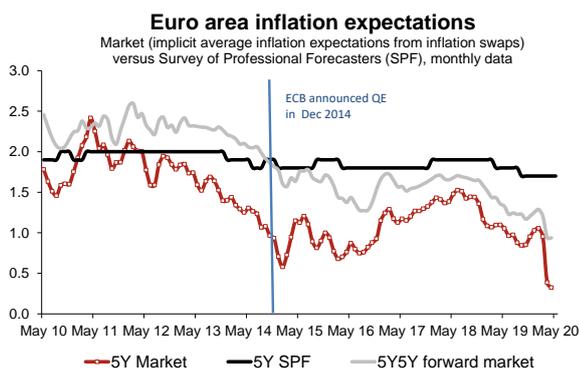
April 30, 2020

ECB: Additional liquidity and credit support measures while speculations about HY purchases were kept alive

- Today the ECB launched further credit support and liquidity measures by creating pandemic emergency longer-term refinancing operations (PELTROs) without a specific lending target at a fixed rate of -0.25 %. It also eased the TLTRO III conditions further to up to -1.0%.
- President Lagarde emphasized the high uncertainty surrounding the current outlook. That said, the ECB expects a gradual recovery as the containment measures are lifted.
- The inclusion of Fallen Angels bonds in asset purchases was not discussed in the Governing Council but speculations about this were kept alive in the Q&A session.
- Looking ahead, we see a high chance that the ECB will again act in June and extend its Pandemic Emergency Purchase Program (PEPP) beyond 2020.

ECB beefed up its policy credit support measures: At today's policy meeting the ECB embarked on additional credit support measures. It set up a new so called pandemic emergency longer-term refinancing operations (PELTROs) program. It consists of seven additional refinancing operations starting in May 2020 and maturing in a staggered sequence between July and September 2021 in line with the duration of the collateral easing measures. The interest rate will be 25 bps below the average rate of the main refinancing operations prevailing over the life of each PELTRO which is -0.25% currently. Moreover, the TLTRO III conditions have been eased further. For lenders reaching the performance threshold, the interest rate over the period from June 2020 to June 2021 will now be 50 basis points below the average deposit facility rate prevailing over the same period. This would be -1.0% currently, before it was -0.75%.

High uncertainty surrounding the outlook: Against the backdrop of its further policy course, Mrs Lagarde emphasized very much the unprecedented nature of this crisis and the high uncertainty surrounding it. The ECB looks for a contraction of euro area output between -5% and -12% as there is yet no clarity about the pandemic, the speed of recovery is uncertain and data about the impact have only started to be released. Still she made clear that the Governing Council continues to see the Covid-19 situation as something temporary. Regarding inflation expectations she pointed out that medium term expectations were less affected than short term ones.



Lagarde keeps speculations about inclusion of HY in PEPP alive: The measures adopted at today's meeting were rather gradual, complementing the liquidity and credit support measures taken so far. Against the backdrop of eased collateral rules to protect Covid-19 induced fallen angels' access to credit, the question is whether the ECB goes further in this direction by including high yield corporate bonds (HY) in its asset purchases. In the Q&A session we learned that the issue was not discussed at today's meeting. That said, Mrs Lagarde advocated very much the PEPP as the appropriate QE tool to fight the crisis. She pointed out several times that the ECB has flexibility with respect to "assets, jurisdictions and across time". The PEPP is the main tool to deal with frictions and the ECB will "not tolerate the risk of fragmentation". This concerns the potential buying of HY as well as the increase of sovereign spreads. Thereby, speculation about the inclusion of HY into the ECB's asset purchases are kept alive and it became clear that it would most likely be done by purchases under the PEPP. Moreover, the Governing Council has decided to publish PEPP purchases with the same granularity as APP ones but on a bi-monthly basis so that we will get to know how much firepower the ECB has used on fighting fragmentation.

Dovish tilt maintained with PEPP extension in June likely: The ECB has acted so far in a decisive, bold and timely manner to the Covid-19 crisis. Looking ahead, we think that more will still need to be done. At the forthcoming June meeting there will be more clarity about the economic fallout and the evolution of the pandemic. We are looking for a bumpy recovery and expect this also to be reflected in the ECB's outlook. As we see it, an extension of the PEPP into 2021 would be appropriate and Mrs Lagarde also mentioned a possible extension of the PEPP today. The Governing Council stated that it "is fully prepared to increase the size of the PEPP and adjust its composition, by as much as necessary and for as long as needed." However, its extension towards HY is something the Governing Council will still have to discuss. Mrs Lagarde pointed out that the ECB measures support credit for all firms and that this was also reflected in the latest Bank Lending Survey. Also, liquidity injected via the PELTRO might support HY as well as sovereign bonds. In the end the degree of market stress in the corporate sector amid the economic outlook will likely be decisive. If needed – this was a message from today's press conference - the ECB would not hesitate to embark on HY purchases.

Latest ECB policy measures

Asset Purchases	Credit/ Liquidity Support
<ul style="list-style-type: none"> • € 120 bn for the CSPP in 2020 • € 750 bn PEPP in 2020 (includes commercial papers, shorter maturities than in PSPP, relaxation of issuer limit more flexible capital key buying) 	<ul style="list-style-type: none"> • LTRO until next round of TLTRO III in June (av. depo rate) • Improved TLTRO III terms for June-2020 to June 2021 period • Banks allowed to operate below required capital level • Collateral easing • Emergency liquidity measures (PELTROs)

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