GENERALI INVESTMENTS

GIAM Macro & Market Research - Market Commentary

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ECB delivers another "whatever-it-takes" moment

- **Following the announcement of a bold policy package at the March 12 meeting the ECB intensified its attempts to fight the pandemic fallout and to restore confidence in EMU.**
- **Yesterday evening it surprisingly launched the Pandemic Emergency Purchase Program (PEPP) with a volume of € 750 bn that can discretionarily be used to fight the coronavirus fallout.**
- **Most important, it could be extended and some self-imposed restrictions like the issuer limit would likely be scrapped if needed.**
- **This unprecedented monetary policy move jointly with the commitment of the Eurogroup to do "*whatever it takes and more, to restore confidence and support a rapid recovery"* goes in the right direction as it helps to stabilize markets and to improve the demand side of the economy.**
- **Overall, markets reacted mixed but positively with euro area sovereign bond spreads narrowing. The 10-year BTP-Bund spread receded by about 50 bps to towards 200 bps whereas the iTraxx crossover has merely narrowed from 707 bps to 670 bps, only a small move towards the 300bps seen a month ago.**

Pandemic Emergency Purchase Program (PEPP) launched: Yesterday evening the ECB surprisingly launched its new QE program "*to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the outbreak and escalating diffusion of the coronavirus, COVID-19.*" At the March 12 policy meeting President Lagarde made clear that the response to the crisis should be "*fiscal first and foremost*". However, the dramatic developments since then – with specifically sovereign euro area bond spreads rising strongly – induced further ECB action. The key features of the PEPP are:

- Volume of € 750 bn, conducted at least until the end of 2020 and will include all the asset categories eligible under the existing asset purchase program (APP).
- Easing of criteria:
    1. Capital keys: Purchases will be conducted in a flexible manner allowing "*fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions*."
    2. Greek bonds will also be included.
    3. CSPP: making all commercial papers of sufficient credit quality eligible.

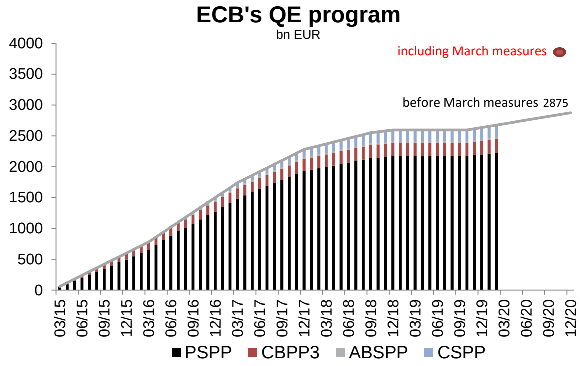
4. Easing of collateral standards: Inclusion of claims related to the financing of the corporate sector. Expansion of the scope of Additional Credit Claims to include claims related to the financing of the corporate sector.

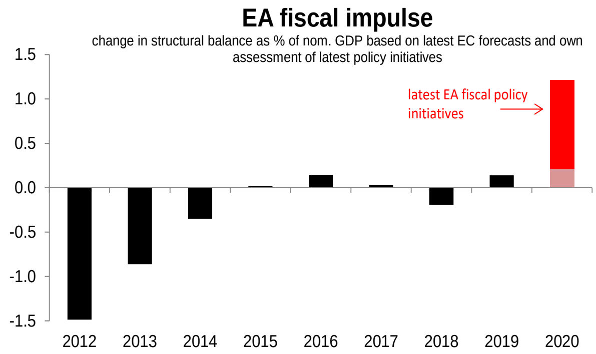
- Readiness to take further action: size and composition might be adjusted and the program will last as long as needed. If "*self-imposed limits might hamper action*" the ECB will "*consider revising them to the extent necessary to make its action proportionate to the risks*" implying to us that in the first place the issuer limit will be abandoned if needed.

- The statement "*The ECB will not tolerate any risks to the smooth transmission of its monetary policy in all jurisdictions of the euro area*." signals in our view that the ECB will not tolerate a widening of sovereign bond spreads beyond a threshold it sees as critical.

Post Draghi ECB also delivered a "whatever-it-takes" moment: Put into perspective, the ECB in a certain way repeated former President Draghi's famous "whatever-it-takes" message. Since the GFC and the euro crisis it had developed new instruments while also imposing some restrictions on them, for instance the 33% issuer limit for government bond buying and QE purchases according to capital keys. We think that the issuer limit would be loosened first as it is already at 50% in case of corporate bond buying. The capital key buying faces higher hurdles in our view as it was introduced to eliminate concerns about direct state deficit financing. Hence, it would probably take something as threatening as the concrete risk of a euro breakup to abandon capital key buying. In any case, yesterday's decision is a good message not only for itself but also because it was sent under the chair of new President Lagarde so that it became clear to everybody that also the post-Draghi ECB is able to take bold decisions. Moreover this shows that not only the ECB has not run out of options yet but is also willing to use them. If needed the PEPP could be extended both in terms of duration, size and asset classes included (e.g. towards bank bonds, equities). Moreover, more extreme and politically as well as legally very problematic options like long term interest rate targeting (like the BoJ does) and even the use of helicopter money could be considered.

Now long awaited fiscal and monetary policy action is there: The monetary policy stimulus from the latest ECB action is very big. At the end of February the various ECB QE programs summed up € 2.8 tr already. Last week the ECB announced extra corporate bond buying (€ 120 bn until YE), additional LTROs as well as TLTROs. Together with the € 750 bn from the PEPP the volume of the ECB's QE alone will sum up to € 3.8 tr and together with the yet unknown volume of the various liquidity programs the total amount will be around € 4 tr or 35% of GDP or even higher. The difference to previous situations is that this time fiscal policy will add to monetary policy action, something the ECB had been demanding for quite some time. On Monday, the Eurogroup gave a strong message about fiscal policy stating that "*We will do whatever it takes and more, to restore confidence and support a rapid recovery*." The combined fiscal measures at national and European levels amount to about 1% of GDP on average and the combined liquidity measures to around 10% of GDP. However we think that in the end the fiscal boost will be even higher. Quite noteworthy, the German government which in the past expressed some obsession about the so called black zero is according to reports now even willing to introduce an exception to its self-imposed debt brake to fight the crisis. Hence, for the first time in its history a coordinated bold monetary and fiscal policy support is put at work. We think that this makes the light at the end of the tunnel shinning brighter and impact positively on markets.





Markets reacted positively: In a knee-jerk reaction financial markets reacted mildly positively to the ECB news. Most important, the 10-year BTP-Bund spread fell by 50 bps towards 200 bps again whereas the iTraxx crossover has merely narrowed from 707 bps to 670 bps, only a small move towards the 300bps seen a month ago. The EUR weakened against the USD. European equity markets trended higher this morning but weakened again thereafter.

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