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Investment Event
ECB: No limits

The European Central Bank (ECB) has announced a temporary EUR750bn bond-buying programme to address the “serious risks” posed by the outbreak of COVID-19

ECB President Lagarde also stated that “there are no limits to our commitment to the euro” amid concerns that a recent rise in borrowing costs could undermine financial stability in the eurozone

Our views

The latest action from the ECB highlights the extent to which global policymakers are willing to push boundaries in order to help mitigate the economic impact of the pandemic

Nevertheless, we still think elevated uncertainty and market volatility justifies a cautious near-term investment strategy

ECB launches COVID-19 QE package

Following an emergency conference call on Wednesday evening, the European Central Bank (ECB) announced a temporary EUR750bn bond-buying programme to address the “serious risks” posed by the outbreak of COVID-19.

The Pandemic Emergency Purchase Programme (PEPP) is to be targeted at both sovereign and private assets and is expected to be conducted until the end of 2020.

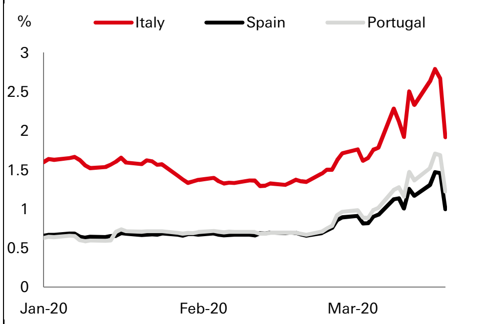
Coupled with the existing Asset Purchase Programme, the ECB will now buy around EUR115bn per month, significantly exceeding the pace of any previous programmes.

- PEPP will last at least until the end of 2020 and until the COVID-19 crisis has passed
- PEPP will cover sovereign and corporate bonds as well as commercial paper
- The ECB will consider raising self-imposed limits on bond holdings
- The ECB will also extend the suite of assets to Greek government debt.

Closing spreads

Markets responded positively to the announcement on Thursday morning with strong demand for government bonds pushing down yields across the eurozone. At market open, yields in the region’s periphery (Italy, Spain, Portugal) fell steeply relative to German yields amid optimism that the scheme would keep a lid on government borrowing costs with pressure on public budgets rising as the economic cost of the COVID-19 outbreak intensifies (Figure 1).

Figure 1: Government bond spreads versus Germany



Source: Bloomberg

In a statement, the ECB declared that it “is fully prepared to increase the size of its asset purchase programmes and adjust their composition, by as much as necessary and for as long as needed.” Peripheral eurozone countries such as Italy and Spain and Portugal have high debt to GDP ratios and are likely to need ongoing assistance to keep yields low.

The policy move is a significant pivot for the ECB whose President Christine Lagarde said last week that it was not the responsibility of the central bank to “close spreads”. After yesterday’s announcement, Lagarde stated that “there are no limits to our commitment to the euro” amid concerns that a recent rise in borrowing costs could undermine financial stability in the eurozone.

Meanwhile, extending the programme to the commercial paper market should ease short-term borrowing costs for businesses, and follows a similar move by the US Federal Reserve this week.

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Investment implications

The latest action from the ECB highlights the extent to which global policymakers are willing to push boundaries in order to help mitigate the economic impact of the pandemic. Nevertheless, despite a positive reaction in European sovereign debt markets following the announcement - and consequently easier financing conditions for governments - these measures are unlikely to avert a significant economic downturn in the region. The response in equity markets has also been relatively muted. We continue to expect market volatility to remain elevated for some time.

In our view, the highly uncertain environment remains consistent with a cautious near-term (1-3 month) investment strategy, including a tactically neutral view on developed market equities.

Nevertheless, it is still important to remember that valuations for risky asset classes – including European equities – have improved significantly following the recent selloff. Investors have already priced in a large amount of bad news. We also recognise that despite huge challenges facing the global economy and populations in the coming weeks, much looser global policy settings (including major action from the ECB and European governments) can set the stage for a gradual recovery in economic activity once the pandemic subsides. For this reason, on a strategic (6-month+) basis we want to maintain a pro-risk investment strategy.

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