ECB unveils surprise bazooka to aid markets

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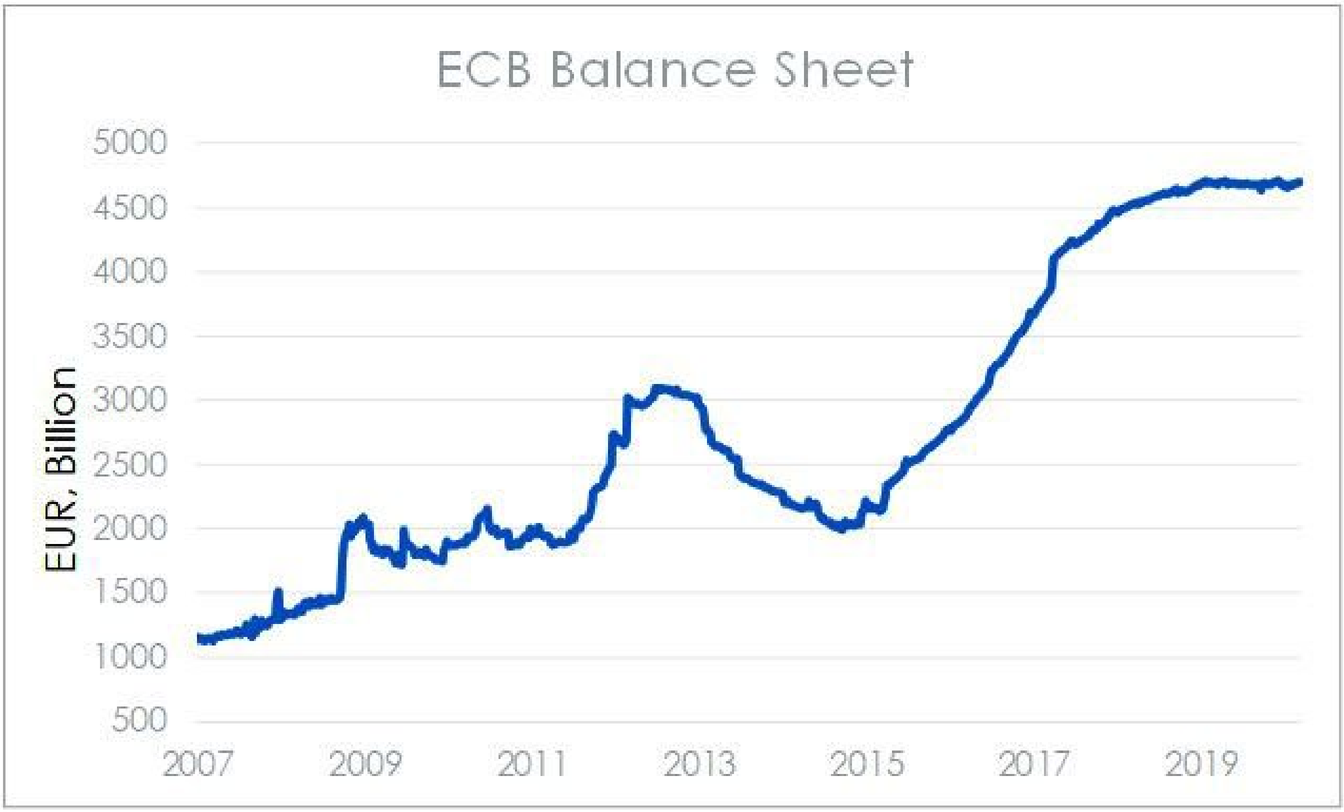
In an emergency meeting held on the night of Thursday, March 19th the European Central Bank (ECB) launched a €750Bn debt buying program in an effort to stabilise the economy amidst the COVID-19 outbreak. The launch of the new Pandemic Emergency Purchase Programme (PEPP) was unveiled to alleviate extreme stress in European bond markets and is an important move in the right direction. The purchases will be conducted until the end of 2020 and will include all asset classes eligible under the existing Asset Purchase Program (APP). The kind of securities and the timing of the purchases will be made at the discretion of the ECB which gives them plenty of flexibility. The ECB has also indicated that, if it needs to, it will ditch the current self-imposed issuer limits that have constrained its purchases. That was essential for any major Quantitative Easing (QE) program to be credible. It has also added commercial paper (short-term corporate debt) to its list of eligible assets and eased collateral constraints. Within the realm of what monetary policy can do, the ECB is helping ease the liquidity crunch facing the European economy and supporting governments within the Eurozone to finance their response to the COVID -19 pandemic. The scale of the new programme (about 6.5% of Eurozone GDP) is a testament of the ECB's new determination to do "whatever it takes". ECB president Christine Lagarde also attempted to rectify her communication mistake at last week's ECB meeting where she denied it was part of her job to close the spreads between peripheral and core bond yields. Last night she reinforced the message that policymakers will do all they can, saying there are "no limits to our commitment to the euro".

Figure 1: European Central Bank Balance Sheet



Source: WisdomTree, Bloomberg as of 13 March 2020.

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The PEPP programme has boosted government bonds. Yields at the market open on 19 March 2020 plummeted in response to ECB's PEPP programme, led by a more than 200-Basis Points drop for Greece's five-year bonds, narrowing the gap between the debt of the euro area's strongest economies and the weakest. Italy's bond yields are down nearly 80 basis points to around 1.65%. Central bank actions can't solve this pandemic crisis on its own, a coordinated fiscal response from the EU is what investors are awaiting. The Eurogroup of finance ministers announced some initial steps on Monday, but the size of the total fiscal commitments remains inadequate in the face of the challenge facing the eurozone.

Unless otherwise stated, data source is Bloomberg, as of 19 March 2020.

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