Press release

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Macro Update:
The ECB takes a significant step

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The ECB issued a new impressive 750bn QE program to deal with the Covid-19 virus. The key elements are that it follows the APP (asset purchase programs) and that it is ambivalently stated regarding the key ratio before maturity in that it seems a tad tougher than the previous program, though importantly Greek bonds are part of the program. Credit easing happens with Commercial Paper and the acceptance of financial claims to the corporate sector as collateral. This is the beginning of dealing with small and mini caps as it will require a risk-sharing framework with banks they need to negotiate. Importantly, the ECB will consider revising its limits.

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html

After risk management led to bloodshed in the sovereign bond market and faced with the size of the shock, this response is far more adequate than the previous decision. Indeed, in an institution now prizing consensus, one should not be surprised that it is more reactive.

This news is very well received in the Greek and Italian bond markets. The stabilization and then drifting lower of yields should help the exposed banks but even before this, the simple drop in volatility should help a lot as it drives risk management. The problem is whether credit risk is absorbed sufficiently, in other words, whether it falls to the neediest in those countries without the fiscal balance to absorb the shock. Hard hit Italy is in a worse position compared to Greece until they change the nature of the program.

The program itself is a gigantic prop for core Europe to help it move through the hole in revenue that has started to gap and is likely to take down some small companies. The stats are that most new companies fail in the first 5 years because of liquidity issues (Banque de France).

The reaction of the EURUSD was that this was a non-event: the same is not be the case in the bond market as it was driven by risk reduction and extreme balance sheet usage. The race now is for the first ones to liberate enough balance sheet to run these carry trades in the periphery. Greek bonds have already appreciated sharply. For this they need a sense that the Covid-19 virus is being contained in Italy, Greece and the rest of Europe to convince their risk manager. A point of extreme convexity is therefore ahead of us - whisper a tad too much and the entire equilibrium will brutally shift until we can safely forecast peak acceleration in the virus.

The ECB's move particularly in its details is very impressive and as other central banks it will eventually move to a risk-sharing framework for small and minicaps. When it does, it will bode very well indeed for Greece and Italy. Banks will be aware of these discussions so that the moves should pre-empt the decision as a way to help finance banks. We welcome the ECB's decision and its consideration for Greece and a hard hit Italy.

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