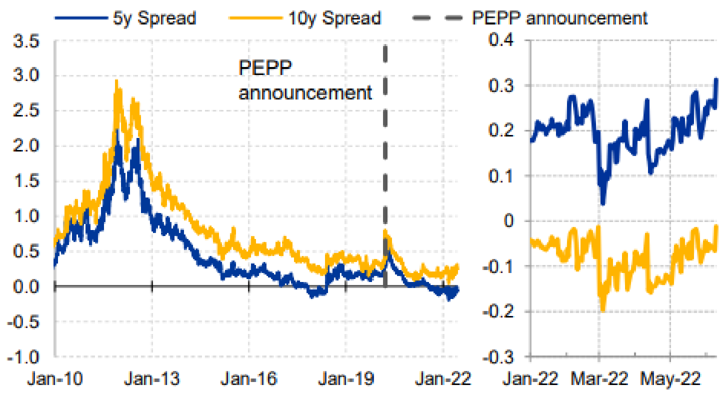
Flash

By François Rimeu, Senior Strategist, La Française AM, 15 | 06 | 2022

June 15th extraordinary meeting of ECB

The European Central Bank (ECB) held an extraordinary meeting today after three consecutive very volatile sessions in European Fixed Income markets. The spread between the 10-year Italian and German Bund moved from 200 basis points (bps) to 242 bps, and we saw similar movements across the board (2-year BTP spread, Greek spread, etc.). We did not expect a reaction from the ECB at such levels of spread considering that overall, spreads are not showing significant stress, as highlighted by Ms Schnabel yesterday.

5-year and 10-year euro area GDP-weighted yield over the equivalent OIS rate
(percentage points)



Source: SDW.
Latest observation: 10 June 2022.
Note: ESTR OIS mid of bid and ask is used, before 10/10/2019 EONIA OIS-8.5bps is used.

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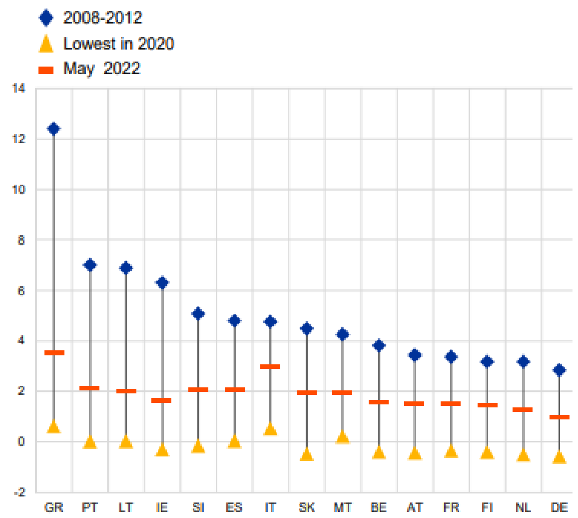
Sovereign bond 10-year yields
(percent, average over period)



Source: ECB Financial Markets database.
Notes: 'Lowest in 2020' displays the lowest average monthly sovereign bond 10-year yield in 2020. Countries are ranked according to the 2008-2012 average monthly sovereign 10-year yield.

The question that everyone is asking is the following: what are the ECB's options?

The ECB must find a solution to achieve its three main objectives:

1. Halt the fall of the Euro,
2. Maintain intra EU spreads at reasonable levels,
3. Fight inflation.

Markets participants have been speculating on this for months now, and we are yet to see any convincing solution. See hereafter what they have indicated today.

- The ECB will apply flexibility in reinvesting PEPP (Pandemic emergency purchase program) redemptions. That was already the case before, so nothing new here. However, the ECB could increase the use of "flexibility" moving forward. They have been reluctant in the past to deviate significantly from the capital key (except during the Covid crisis for a short period of time), but they could decide to do so. Doing so may prove difficult over the long term (the ECB has to respect the capital key by the end of any calendar year, see https://www.ecb.europa.eu/mopo/implement/pepp/html/pepp-qa.en.html), but it could help to stabilize markets over the short term.
- The ECB told staff to prepare new anti-crisis tools for approval. We do not have any details yet, but this is what markets were hoping for last week before the ECB meeting. It is too soon to formulate an opinion on the plan, and it is still not clear how much support the plan will have among ECB members.

The fact that the ECB is stepping in should calm markets over the short term, especially given the reduced exposure to peripheral countries. However, they must now deliver on their new anti-crisis tools. If it means a new Quantitative Easing (QE) program, dedicated to peripherals countries, we are hesitant. We do not think it would be possible without conditionality. It could be a new plan similar to the Outright Monetary Transactions (OMT) program, but with more flexibility and light conditionality. For now, this seems to be the most plausible outcome. Will it be enough to keep peripheral spreads from widening? We are not sure about that, at least not until inflation comes down.