Lagarde Sparks Bond Rally After ECB Eases Money Market Stress

2020-04-30 15:47:30.375 GMT

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(Bloomberg) -- Money markets and bonds showed immediate signs of relief after the European Central Bank cut the cost of money to banks and added another source of funding.

Euribor interest-rate futures rose across the curve, an indication that the cost of borrowing for banks will likely fall, after the ECB eased conditions on long-term loans to banks. It also introduced so-called "PELTROs" in a further effort to loosen the flow of money and help backstop existing loans when they mature.

That spurred a rally in sovereign bonds on the prospect that easier access to cash will prompt domestic lenders to buy more debt. The securities also received a boost after President Christine Lagarde said the ECB stood ready to increase the size of its asset purchases.

"Liquidity galore is what we could call this ECB meeting," said Antoine Bouvet, a senior rates strategist at ING Groep NV. "The ECB is taking no chance: they are making sure banks have all the cash they need to finance themselves and to finance the economy."

Easing funding conditions could be what Europe's banks need to keep money flowing into the region's economies devastated by the coronavirus. The move is especially pertinent after companies clamoring for cash sent the three-month Euro Interbank Offered Rate last week to the highest since 2016.

June FRA/OIS, a measure of funding stress this summer, fell two basis points to a seven-week low. The yield on Italian two-year securities slid as much as 19 basis points after the decision to 0.51%, before paring the move. German 10-year bund yields fell nine basis points to -0.58%.

Brief Upset

While the ECB didn't announce an increase to its pandemic emergency purchase program as hoped for by some bond investors -- sending longer-dated Italian bonds lower -- Lagarde echoed a famous comment by predecessor Mario Draghi by saying the institution was ready to do whatever was needed.

"We are, therefore, fully prepared to increase the size of the PEPP and adjust its composition, by as much as necessary and for as long as needed," said Lagarde.

Italy's 10-year bonds spent most of the afternoon in the red before steadying toward the end of the trading session.

The institution is already set to buy over one trillion euros of assets ($1.09 trillion) in the region to help cushion the economic fallout from the coronavirus. Analysts are looking for policy makers to boost quantitative easing at some point this year and money markets have bet on another ECB interest-rate cut in 2021.

'Go Ballistic'

The flood of promised money initially put pressure on the euro, before month-end trading weakened the dollar and sent the

common currency up as much as 0.9% to $1.0972. European stocks
extended losses.

The ECB lowered the interest rate on targeted longer term refinancing operations to 50 basis points below the average interest rate on the Eurosystem's main refinancing operations prevailing over the same period. Italy's front-end bonds, which reflect default risk, are most sensitive to easier lending conditions to banks, given domestic lenders tend to dominate the market.

"Unless there is a stigma attached to borrowing under TLTRO, the banks should go ballistic," said Rishi Mishra, an analyst at Futures First. "Now, you can borrow at minus 50 basis points, and park at minus 50 basis points if you don't find a borrower. And if you do find a borrower, even better, you can get 50 basis points extra."

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