Bond Blog

PGIM FIXED INCOME

March 16, 2023

ECB: Having It Both Ways, For Now

Katharine Neiss, PhD, Chief European Economist
Guillermo Felices, PhD, Global Investment Strategist

As expected, the ECB stuck with its guidance and raised interest rates 50 basis points (bps) at its March policy meeting. However, recent market turmoil has clearly made the central bank cautious.

The ECB has multiple objectives to deliver, including price stability and financial stability. Its communications today demonstrate that it is not stepping back from either. Yes, it raised interest rates to return inflation to target. But it acknowledged that, perhaps, rates shouldn't go up aggressively, to avoid triggering further market turbulence or tightening financial conditions more than intended.

Our Take on the ECB's March Meeting: No Trade-off between Inflation and Financial Stability

Today's ECB decision contains all the key elements we were looking for. First, the bank stuck to a well-telegraphed 50 bps hike to deal with inflation. At the same time, its accompanying announcement acknowledged recent financial market turmoil, so as not to appear tone-deaf.

Second, the bank didn't mention accelerating the pace of quantitative tightening (QT) beyond Q2 of this year, which we view as the right call. Additionally, today's policy statement provided reassurance on liquidity tools as well as regulatory and supervisory oversight within the eurozone, strong fundamentals worth highlighting.

Third, the statement and President Lagarde's comments at the press conference conveyed a notable dovish shift. Both emphasized data dependence and stepped away from signaling successive rate hikes to come. This was an important change and makes it possible that this hike may be the last – for the foreseeable future.

Indeed, a shift in macroeconomic fundamentals could warrant a more dovish approach: credit provision in Europe is relatively bank-based and, other things equal, recent turbulence would therefore map into tighter financial conditions than elsewhere. In our view, it is notable that the ECB emphasized the strength of the monetary transmission mechanism in judging the appropriate path for future interest rates.

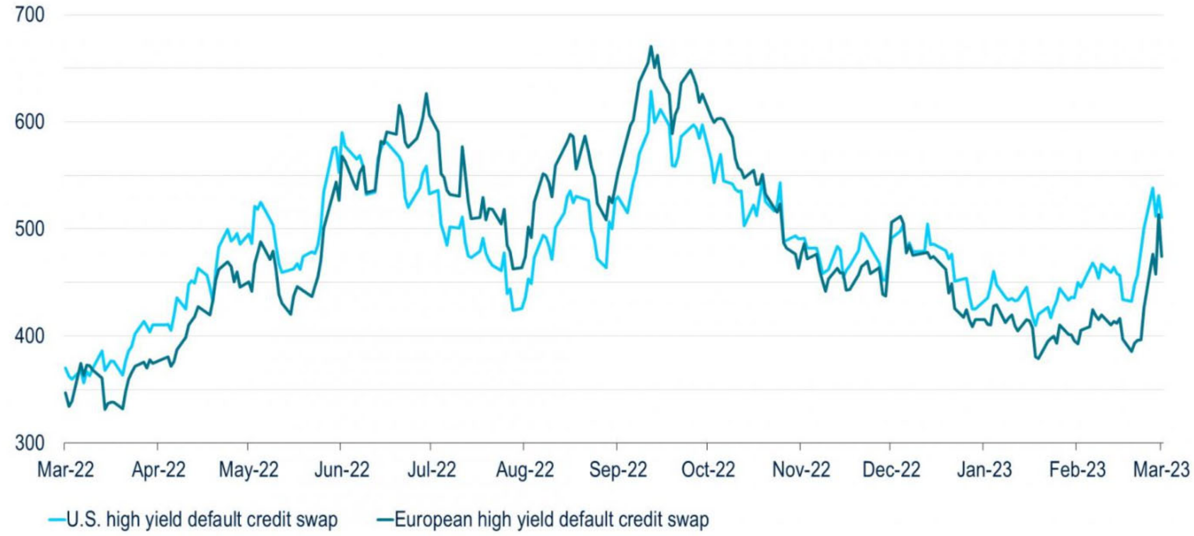
Market Reaction

Today's ECB message was decidedly less hawkish than December's and qualifies as a dovish 50 bps hike. Also notable was the lack of forward-looking guidance. This was in line with the increased uncertainty mentioned in the press release.

Immediate market reaction welcomed the ECB's "dovish hike". German yields rose slightly, across the curve, after declining materially in the past few days. Front-end rates markets now price in a terminal rate of 3.22% in this cycle, not so different from where they were before the meeting.

Risk assets also behaved well in the immediate aftermath. Peripheral sovereign spreads, which had widened since early March, remained contained before and after today's meeting. Corporate spreads, in both investment-grade and high-yield (HY) markets, compressed slightly after the meeting. Interestingly, euro-denominated HY credit default swap (CDS) spreads ("iTraxx Crossover") did not deviate materially from U.S. HY CDS spreads ("CDX HY"). This suggests that the ECB's decision to hike by 50 bps hasn't exacerbated risk aversion in eurozone assets (Figure 1). A slight bounce in European equities, together with the stability of bank stocks, corroborated this view.

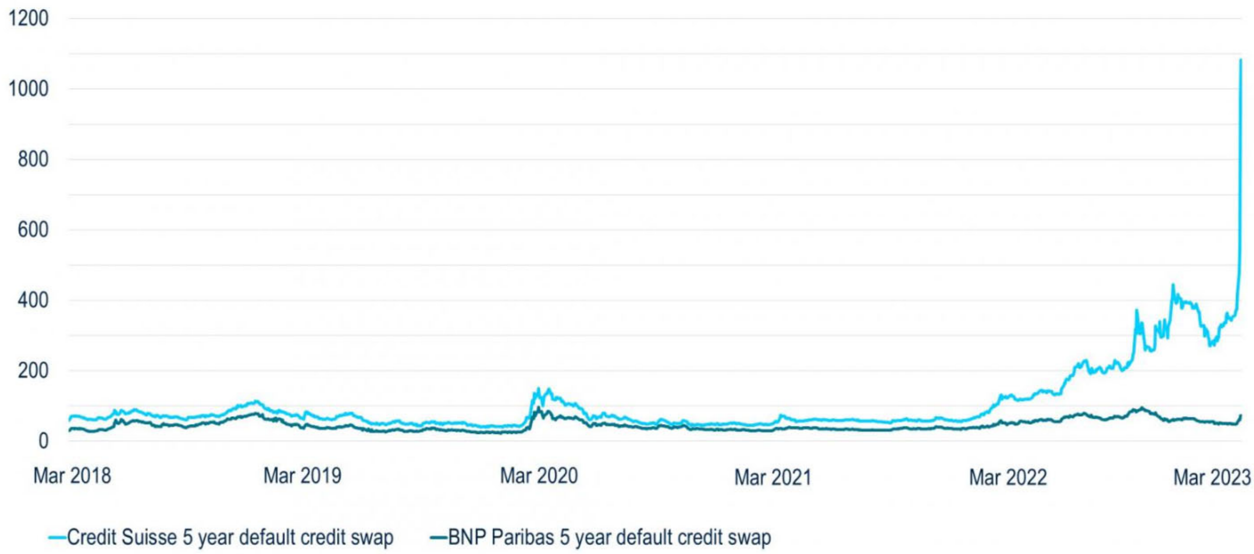
FIGURE 1: Eurozone and U.S. high-yield CDS moved in sync after today's ECB rate hike.



Source: Bloomberg.

Overall, we believe that the ECB decision to hike 50 bps while striking a dovish tone didn't exacerbate the previous day's Credit Suisse-driven risk selloff (Figure 2). This is quite an accomplishment given recent market anxiety. Looking ahead, several unresolved issues remain, including the fragility of Credit Suisse/financial stress, the conduct of monetary policy, and the associated macroeconomic and market outcomes.

FIGURE 2: Today's ECB rate hike did not exacerbate Credit Suisse CDS prices.



Source: Bloomberg.

Conclusion

The ECB's actions and communications today speak to a more moderate and measured pace of rate rises going forward, which we believe will peak around 3.5% by year-end. In addition, the bank has alternative tools on standby to address market turmoil. Its resolve today could pave the way for the Fed next week.

Market reaction immediately after the ECB's decision suggest that the bank's "dovish hike" struck the right tone. Investors appear to lend credence to the ECB's message that the banking system is resilient. Concerns about Credit Suisse have not escalated to systemic proportions.

However, threading the needle between monetary policy and financial stability will remain a difficult task as long as inflation remains high and Credit Suisse's solvency issues linger. European risk assets will remain vulnerable until those concerns are resolved.

Source(s) of data (unless otherwise noted): PGIM Fixed Income, as 3/16/2023.

Important Information

PGIM Fixed Income operates primarily through PGIM, Inc., a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended, and a Prudential Financial, Inc. ("PFI") company. Registration as a registered investment adviser does not imply a certain level or skill or training. PGIM Fixed Income is headquartered in Newark, New Jersey and also includes the following businesses globally: (i) the public fixed income unit within PGIM Limited, located in London; (ii) PGIM Netherlands B.V., located in Amsterdam; (iii) PGIM Japan Co., Ltd. ("PGIM Japan"), located in Tokyo; (iv) the public fixed income unit within PGIM (Hong Kong) Ltd. located in Hong Kong; and (v) the public fixed income unit within PGIM (Singapore) Pte. Ltd., located in Singapore ("PGIM Singapore"). PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. Prudential, PGIM, their respective logos, and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

These materials are for informational or educational purposes only. The information is not intended as investment advice and is not a recommendation about managing or investing assets. In providing these materials, PGIM is not acting as your fiduciary. Clients seeking information regarding their particular investment needs should contact their financial professional. These materials represent the views and opinions of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person's advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of PGIM Fixed Income is prohibited. Certain information contained herein has been obtained from sources that PGIM Fixed Income believes to be reliable as of the date presented; however, PGIM Fixed Income cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Fixed Income has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy or accept responsibility for errors. All investments involve risk, including the possible loss of capital. These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. No risk management technique can guarantee the mitigation or elimination of risk in any market environment. Past performance is not a guarantee or a reliable indicator of future results and an investment could lose value. No liability whatsoever is accepted for any loss (whether direct, indirect, or consequential) that may arise from any use of the information contained in or derived from this report. PGIM Fixed Income and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Fixed Income or its affiliates.

The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients or prospects. No determination has been made regarding the suitability of any securities, financial instruments or strategies for particular clients or prospects. For any securities or financial instruments mentioned herein, the recipient(s) of this report must make its own independent decisions.

Conflicts of Interest: PGIM Fixed Income and its affiliates may have investment advisory or other business relationships with the issuers of securities referenced herein. PGIM Fixed Income and its affiliates, officers, directors and employees may from time to time have long or short positions in and buy or sell securities or financial instruments referenced herein. PGIM Fixed Income and its affiliates may develop and publish research that is independent of, and different than, the recommendations contained herein. PGIM Fixed Income's personnel other than the author(s), such as sales, marketing and trading personnel, may provide oral or written market commentary or ideas to PGIM Fixed Income's clients or prospects or proprietary investment ideas that differ from the views expressed herein. Additional information regarding actual and potential conflicts of interest is available in Part 2A of PGIM Fixed Income's Form ADV.

In the United Kingdom, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR. PGIM Limited is authorised and regulated by the Financial Conduct Authority ("FCA") of the United Kingdom (Firm Reference Number 193418). In the European Economic Area ("EEA"), information is issued by PGIM Netherlands B.V., an entity authorised by the Autoriteit Financiële Markten ("AFM") in the Netherlands and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited under temporary permission arrangements following the exit of the United Kingdom from the European Union. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II). In certain countries in Asia-Pacific, information is presented by PGIM (Singapore) Pte. Ltd., a Singapore investment manager registered with and licensed by the Monetary Authority of Singapore. In Japan, information is presented by PGIM Japan Co. Ltd., registered investment adviser with the Japanese Financial Services Agency. In South Korea, information is presented by PGIM, Inc., which is licensed to provide discretionary investment management services directly to South Korean investors. In Hong Kong, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors as defined in Section 1 of Part 1 of Schedule 1 (paragraph (a) to (i) of the Securities and Futures Ordinance (Cap.571). In Australia, this information is presented by PGIM (Australia) Pty Ltd ("PGIM Australia") for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). PGIM Australia is a representative of PGIM Limited, which is exempt from the requirement to hold an Australian Financial Services License under the Australian Corporations Act 2001 in respect of financial services. PGIM Limited is exempt by virtue of its regulation by the FCA (Reg: 193418) under the laws of the United Kingdom and the application of ASIC Class Order 03/1099. The laws of the United Kingdom differ from Australian laws. In South Africa, PGIM, Inc. is an authorised financial services provider – FSP number 49012. In Canada, pursuant to the international adviser registration exemption in National Instrument 31-103, PGIM, Inc. is informing you of that: (1) PGIM, Inc. is not registered in Canada and is advising you in reliance upon an exemption from the adviser registration requirement under National Instrument 31-103; (2) PGIM, Inc.'s jurisdiction of residence is New Jersey, U.S.A.; (3) there may be difficulty enforcing legal rights against PGIM, Inc. because it is resident outside of Canada and all or substantially all of its assets may be situated outside of Canada; and (4) the name and address of the agent for service of process of PGIM, Inc. in the applicable Provinces of Canada are as follows: in Québec: Borden Ladner Gervais LLP, 1000 de La Gauchetière Street West, Suite 900 Montréal, QC H3B 5H4; in British Columbia: Borden Ladner Gervais LLP, 1200 Waterfront Centre, 200 Burrard Street, Vancouver, BC V7X 1T2; in Ontario: Borden Ladner Gervais LLP, 22 Adelaide Street West, Suite 3400, Toronto, ON M5H 4E3; in Nova Scotia: Cox & Palmer, Q.C., 1100 Purdy's Wharf Tower One, 1959 Upper Water Street, P.O. Box 2380 - Stn Central RPO, Halifax, NS B3J 3E5; in Alberta: Borden Ladner Gervais LLP, 530 Third Avenue S.W., Calgary, AB T2P R3.

2023-2378

留意事項

※本資料はPGIMフィクト・インカムが市場動向に関する情報提供としてプロの投資家向けに作成したものです。PGIMフィクスト・インカムは、米国SECの登録投資顧問会社であるPGIMインクの債券運用部門です。

※本資料は情報提供を目的としたものであり、特定の金融商品の勧誘又は販売を目的としたものではありません。また、本資料に記載された内容等については今後変更されることもあります。

※記載されている市場動向等は現時点での見解であり、これらは今後変更することもあります。また、その結果の確実性を表明するものではなく、将来の市場環境の変動等を保証するものでもありません。

※本資料で言及されている個別銘柄は例示のみを目的とするものであり、特定の個別銘柄への投資を推奨するものではありません。

※本資料に記載されている市場関連データ及び情報等は信頼できると判断した各種情報源から入手したものですが、その情報の正確性、確実性について当社が保証するものではありません。

※過去の運用実績は必ずしも将来の運用成果等を保証するものではありません。

※本資料は法務、会計、税務上のアドバイスあるいは投資推奨等を行うために作成されたものではありません。

※PGIMジャパン株式会社は、世界最大級の金融サービス機関プルデンシャル・ファイナンシャルの一員であり、英国プルーデンシャル社とはなんら関係がありません。

PGIMジャパン株式会社
金融商品取引業者 関東財務局長（金商）第392号
加入協会 一般社団法人日本投資顧問業協会、一般社団法人投資信託協会
PGIMJ97604