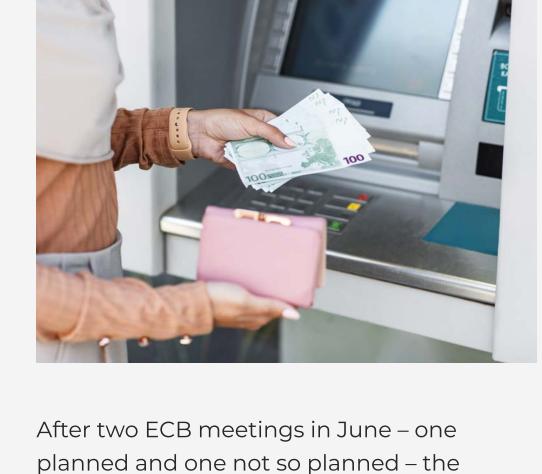
## **ECB** has shown their hand



inflation and a seeming lack of intention to get it, this will lead to difficult times for investors as well as normal income earners. Sorry ECB, but we are eating and using energy every day

European central bank has shown its hand

and it is not a strong one. With no grip on

## evidence that this will change short term. While headline inflation is topping 8% the

been rising all year and there is so far little

The headline figures for inflation (HICP) have

ECB in the policy meeting on 9 June announced that they expect headline inflation in 2022 of 6.8%.

**Table 1 -** Euroarea - current indicators and

Inflation ex food & energy

3.8%

ECB staff projection

GDP\*

5.4%

ECB staff projections

May 2022 / 2021\*

Inflation (HICP)

8.1%

2.8% 2022 68% 3.3% 2023 3.5% 2.8% 2.1% 2024 2.1% ECB has been arguing that inflation ex food

and energy is not that high. Unfortunately, most people in the Euroarea are eating and

far worse off on items that matter to the

down but purchasing power lost is still

Furthermore, it is striking that ECB is

robust growth rates until 2024.

purchasing power lost.

normal family. It can be inflation will come

nervous about the economy entering into a

recession, but their GDP forecast is showing

using energy everyday. In real terms they are

As unemployment rates are at the lowest level for more than 30 years in EU, it is surprising that inflation is falling that fast in the staff projections. The implied goods and service inflation in the staff projection should fall to under 2% in

2024. That is a very optimistic view, and

difficult to reconcile with current supply

unemployment rates.

bonds 4.25%.

have to pay.

year bonds reach 2.5%.

chain problems, the war in Ukraine, and low

signaled their intention to increase interest rates, European government bonds sold off

heavily with German 10-year Bunds reaching

1.75% in yield and Italian 10 year government

The spread between German and Italien 10-

## **Anti-fragmentation** instrument After the 9 June meeting, where ECB

These are levels of interest rates with the Italian government cannot handle with a debt to GDP ratio of more than 150%, which the Italian premier minister Mr Draghi probably has explained this to his successor as president of the ECB.

ECB's Governing council has "decided that it

will apply flexibility in reinvesting

If 4.25% was too high an interest rate then an educated guess is it going to be less. We will have to wait for the actual announcement from ECB.

If ECB increases the short-term interest rates

as expected and de facto put a maximum

government bonds the yield is going steep

the 3-5 years to 30 years for countries with a

in the short end and completely flat from

Impact for investors

level on the interest rate on long

high debt to GDP ratio.

a number of years.

redemptions coming due in the PEPP portfolio" as well as implement "a new antifragmentation instrument". Our interpretation of the press release is that the Governing Council will in fact put a cap on the interest rates which Italy and other countries with high debt to GDP ratio will

## The German government yield curve could be almost completely flat in this scenario from 1 to 30 years.

Credit spreads, which are not linked to

government bonds will more correctly

excess the risk premium for holding for

instance an Italian credit risk. Most likely the

credit market will become highly volatile for

If the credit market becomes volatile so will

equity markets. Most likely we are going into a period with risk on/risk off all the time. It is highly unlikely, that ECB staff projection will materialize, and continued high inflation will most likely have an adverse impact on equity prices. Capital will flow in and out of the government

bonds which for the first time in 5 years will

give a positive interest rate depending on

Roller Coaster and summer

actual risk appetite in the market.

ECB and the governing council has managed to get to far behind the curve, that they will have to invent a new financial policy instrument to save the situation. In our opinion this will lead to a roller coaster environment in the coming year in the financial market which will be very difficult

to navigate. However, it will also create a lot

of opportunities for the investor which are

well prepared for such an environment.

Speaking of roller coaster, the summer is over us, the amusement parks are open and everyone should get out and enjoy a hopefully wonderful summer. We wish all a warm and sunny summer with family and friends.

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