

EGB MARKET

OUTLOOK BIMICG-ECB 10 NOVEMBER

2022

Nathalie Fillet



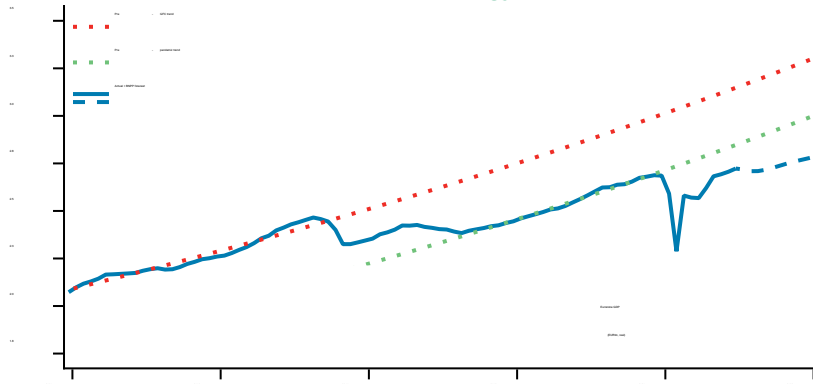
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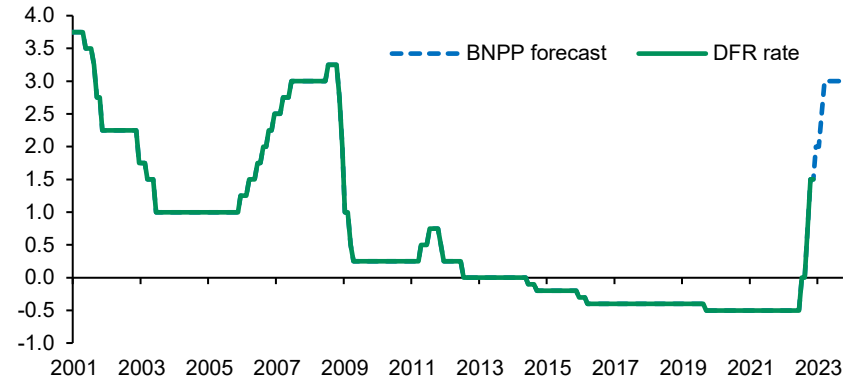
Eurozone Macroeconomic Outlook

Eurozone looks set to suffer a significant degree of permanent scarring on the back of the energy shock



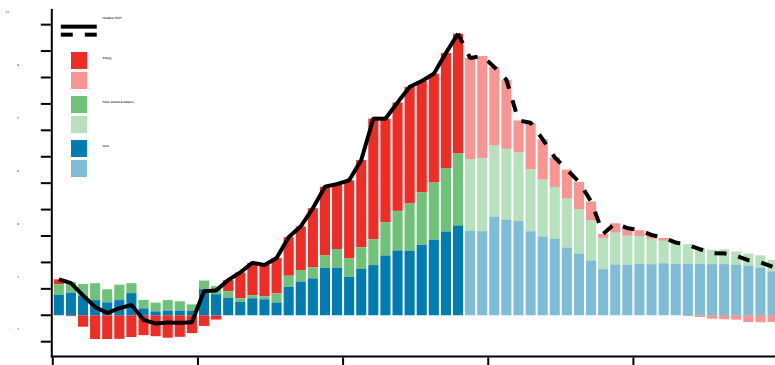
Sources: Eurostat, Macrobond, BNP Paribas forecasts

BNP Paribas deposit facility rate forecast (%)



Sources: ECB, BNP Paribas

Headline HICP decomposition and forecast (% y/y)



Note: forecasts as of October 3rd. Sources: Eurostat, Macrobond, BNP Paribas

- **A eurozone recession is inevitable.** A combination of domestic and global headwinds look set to put the eurozone into recessionary territory. Fiscal policy support should prevent a *deep* one, but we expect a prolonged period of sluggish activity, with below-trend growth throughout 2023–24.
- **A regime shift in inflation is underway.** inflation shock to be persistent. While headline inflation will ease significantly next year – primarily reflecting base effects from energy – underlying inflation is set to remain sticky. Wage growth is likely to continue to build despite the recession.
- **ECB: a more cautious stance but takes rates into ‘restrictive’ territory.**
 - Expected downshift in the pace of tightening in December, from 75bp to 50bp,
 - But the DFR is expected to reach 3.00% by end-Q1, consistent with rates moving into ‘restrictive’ territory.
 - The ECB is set to announce the key principles behind QT at the December meeting. Ending full reinvestment looks more likely than outright sales. Our central case is for QT beginning in H1 2023.



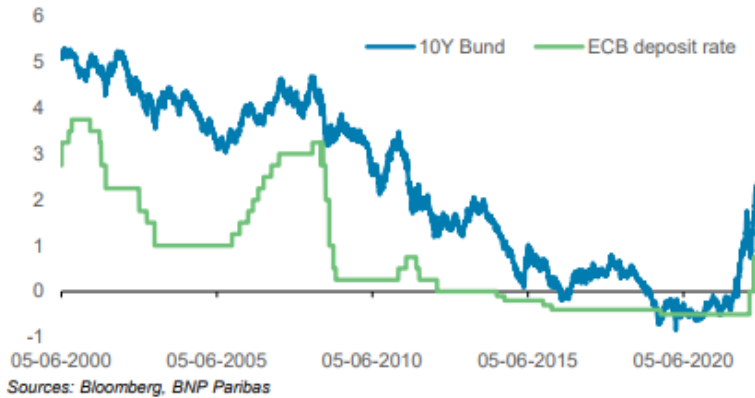
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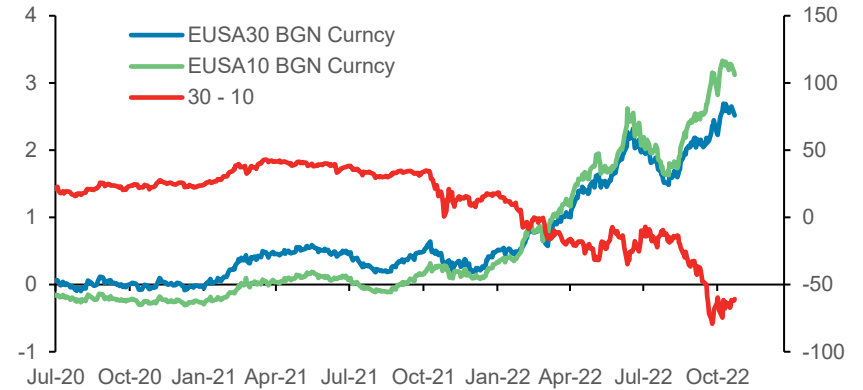
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EGB market review

10y Bund yield and deposit rate since 1999



10s30s some resistance around 2% for the 30y



Realized volatility coming down but still on very high levels



Race to neutral not over for the ECB: Upward pressures due to the hiking cycle will likely be reinforced by discussions about quantitative tightening at upcoming meetings, and high net supply in Q1 2023.

How long those pressures last depends on how far into restrictive territory the ECB goes – as the ‘neutral’ rate has not been reached, we expect higher yields in the near future (we forecast the 10y Bund yield to approach 3% in Q1 2023).

Curve direction: two opposite forces on 2-10y spreads

- flatter ahead of recession and US curve likely to invert further as the market prices in a longer and higher cycle after the Feb last week
- steeper on the back of higher net supply (gross supply to remain elevated and introduction of QT)

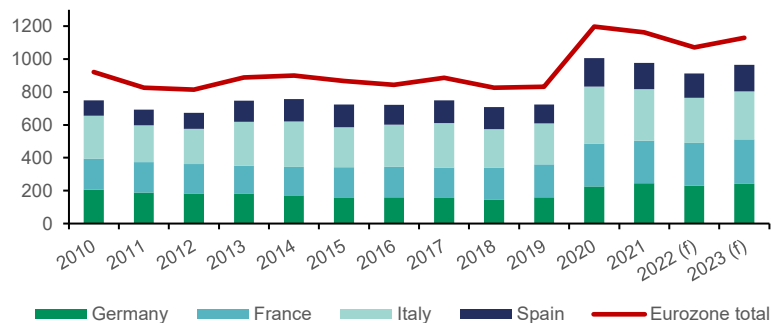


2023 EGB supply outlook

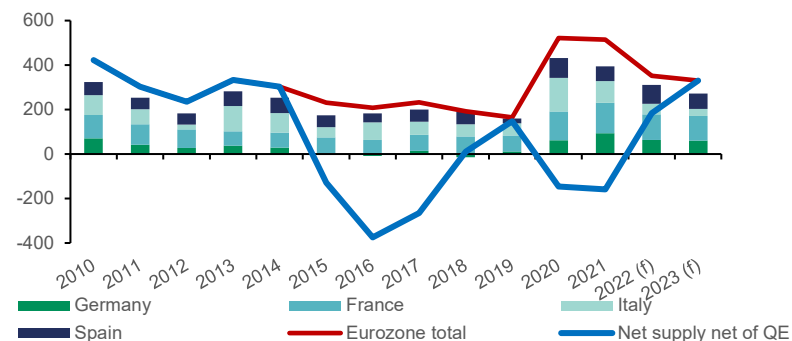
2023 supply projections (EURbn)

	2023		2022		Changes vs 2022			2023 QT scenarios				
	2023 gross supply	2023 net supply	2022 gross supply	2022 net supply	2022 net supply net of QE	Chg in gross supply	Chg in net supply	Chg in 2023 net supply vs 2022 net supply net of QE	2023 net supply net of QT assuming 50% roll-off, starting in Jan	2023 net supply net of QT assuming 50% roll-off in Jan, then 100% in Jul	2023 net supply net of QT assuming 50% roll-off, starting in Apr	2023 net supply net of QT assuming 50% roll-off in Apr, then 100% in Sep
A	B	C	D	E	A-C	B-D	B-E	1	Scenario 2	Scenario 3	Scenario 4	
Austria	39	12	40	14	7	-1	-2	5	16	19	16	17
Belgium	43	22	41	14	6	2	8	16	24	25	24	25
Finland	16	5	18	7	3	-1	-2	2	7	8	7	8
France	270	111	260	115	83	10	-4	27	129	137	124	130
Germany	242	60	231	63	22	12	-3	38	88	99	82	90
Greece	4	0	11	6	4	-6	-6	-4	0	0	0	0
Ireland	7	0	7	-5	-7	0	5	7	1	1	0	0
Italy	290	31	274	47	7	17	-16	24	59	75	54	64
Netherlands	49	19	40	9	3	9	9	16	23	26	21	21
Portugal	11	0	13	1	-4	-3	-1	4	2	3	2	3
Spain	161	70	148	85	63	13	-15	7	82	88	79	83
Total	1134	329	1082	357	187	52	-27	142	430	480	409	441

Eurozone gross supply over time (EURbn)*



Eurozone net supply over time (EURbn)*



*Excludes Greece. Sources: National treasuries, European Commission, Bloomberg, BNP Paribas



Discussion points

1. How big is the risk of a long and durable stagflation worldwide.
2. Is the deterioration of market depth and liquidity temporary or structural (without QE, more limited capacity for intermediation and more regulations)
3. How implements active QT without resulting in another huge selloff – BoE example?
4. Is the failed auction in Germany in October (new 7y Bund) a one-off or a trigger to change issuing models (new environment, coming QT and remaining important borrowing needs from sovereigns)



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