

## Money Market Contact Group December 2013

J.P. Morgan

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# Key Developments

## Macro Environment

- Euro wide pricing pressure slowing considerably giving rise to concerns about the growing risk of deflation
- US economy appears to have shrugged off immediate fear of damage due to the Debt Ceiling negotiations and Tapering to post strong Payrolls figures
- Rates seen on hold until 2016 – slight bias towards easing but would require another shock

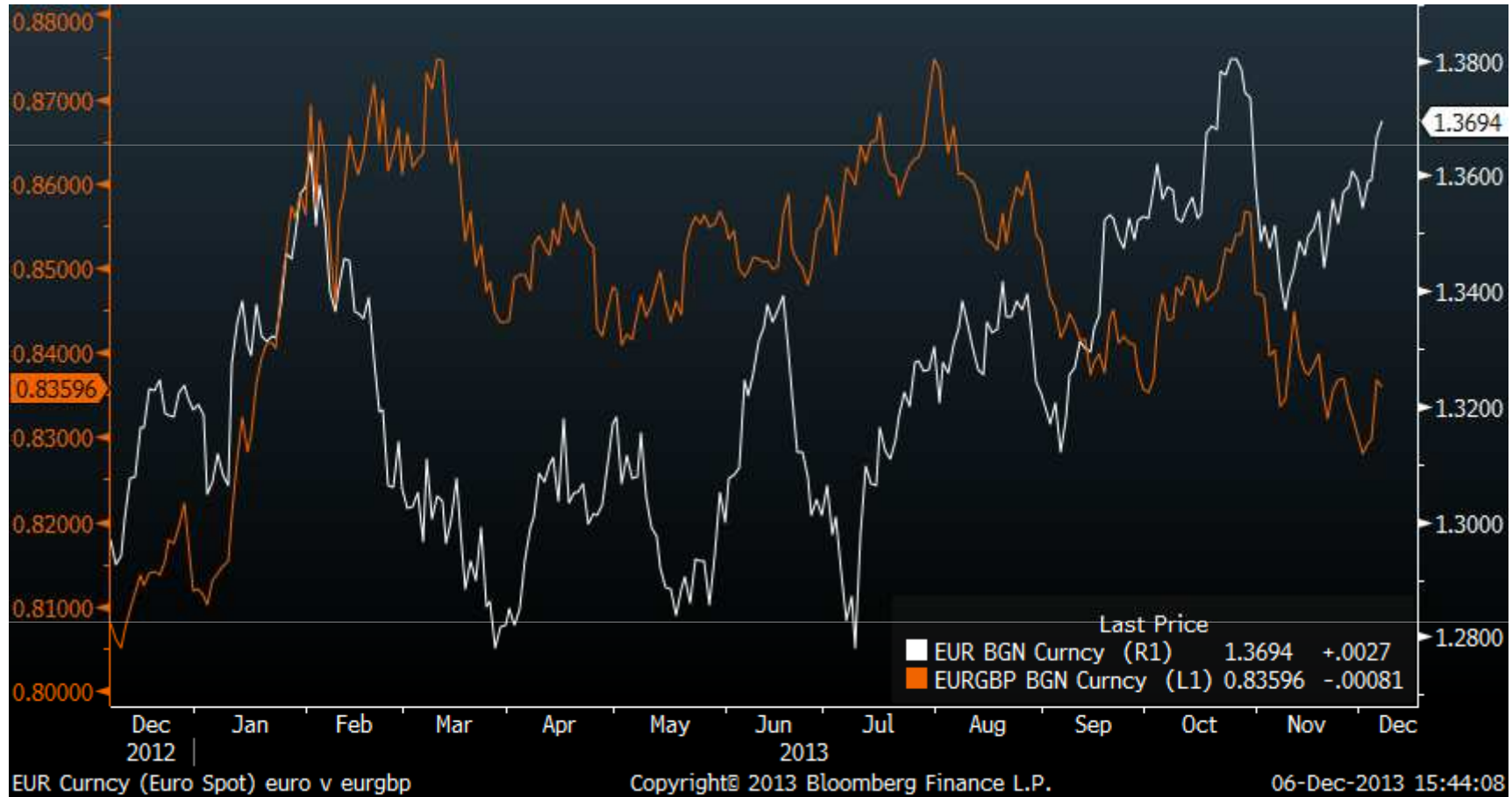
## Monetary Policy

- ECB's 25pt cut to the Refi rate while leaving rate on Deposit Facility unchanged
- Market taken by surprise by the move despite forward guidance

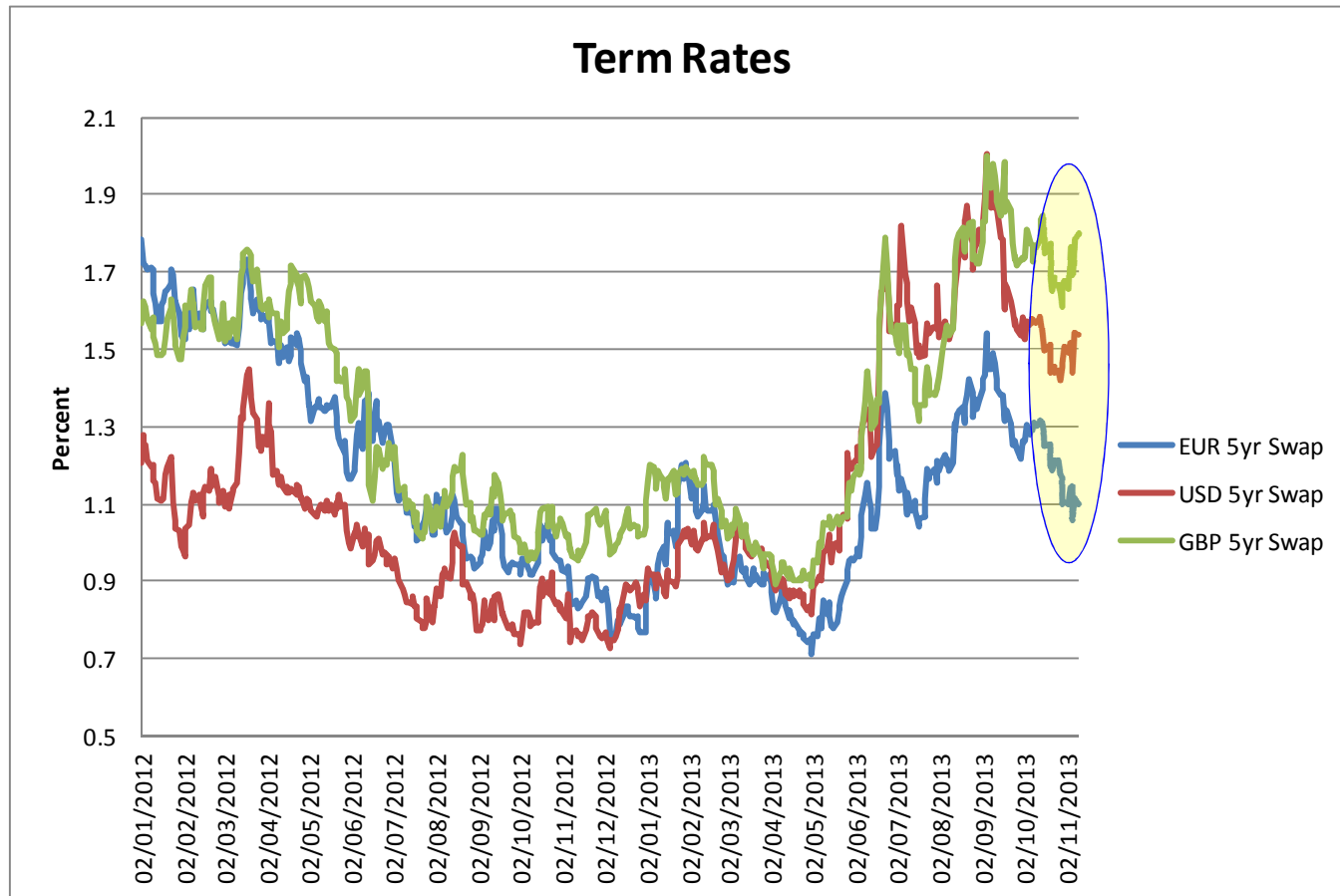
## Regulatory

- EBA's stance on Leverage Ratio to be closely monitored
- Impact of liquidity regulation and central bank monetary policy
- Availability and concentration of liquid assets to meet liquidity and margin requirements
- Harmonisation under the Single Europe Rulebook
- Recovery and Resolution

### EURUSD vs EURGBP

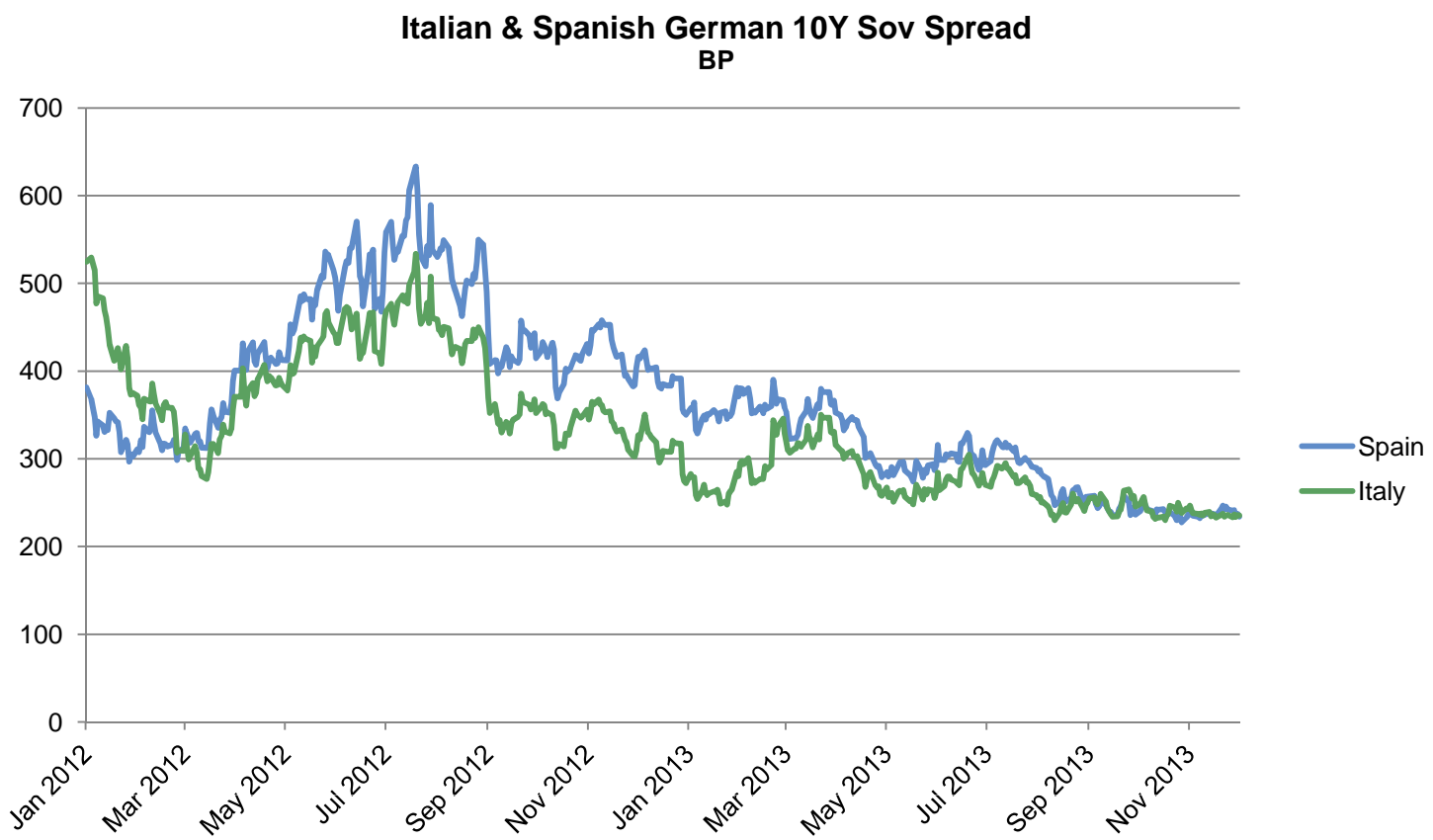


- EURUSD proved surprisingly resilient over past quarters



- Breakdown in rate correlation between EUR, GBP and USD term rates

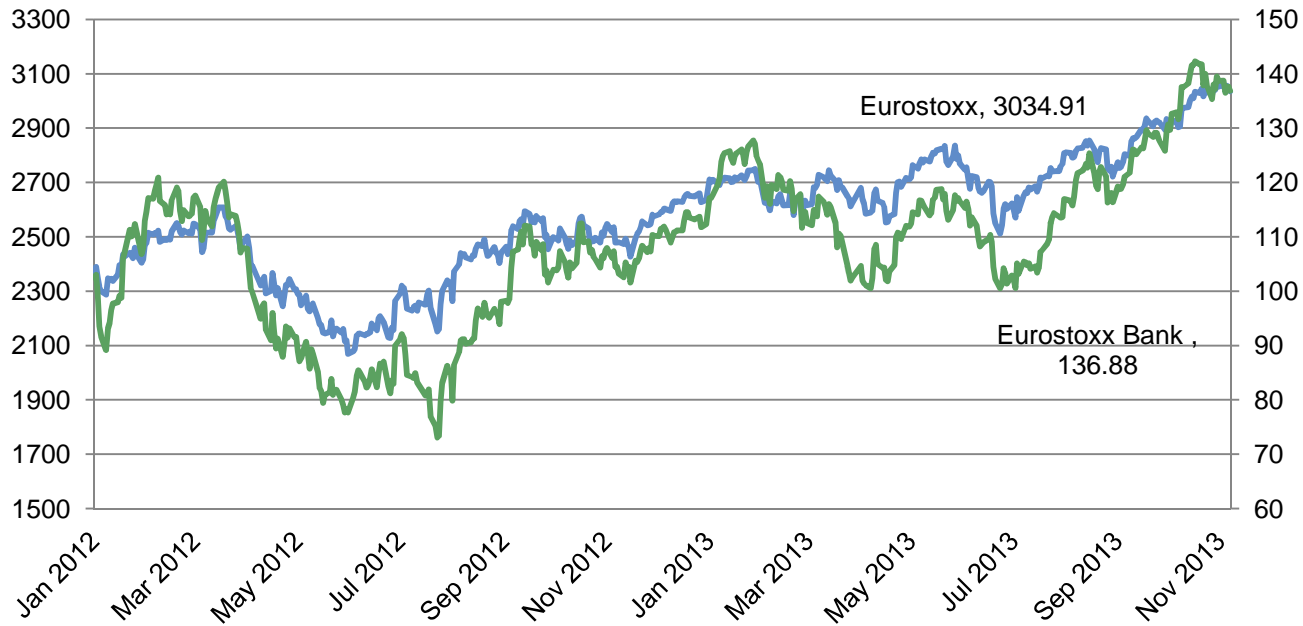
# Peripheral Spreads vs Germany



- Spreads for both Italy and Spain trending lower
- Significantly reduction in volatility

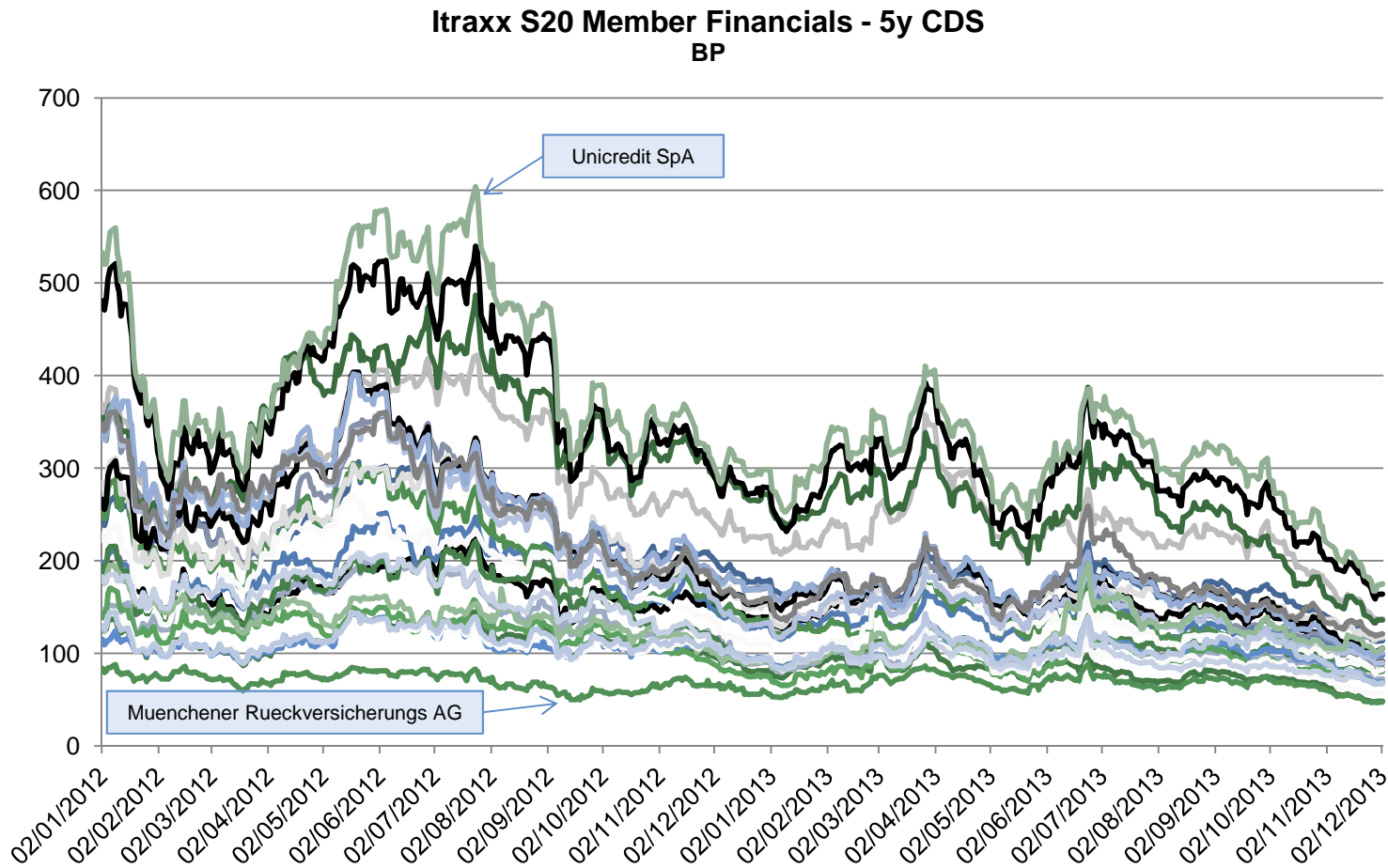
### Eurostoxx Bank Index vs Broader Market

Eurostoxx; blue; left axis / Eurostoxx Bank; green; right axis



- Sentiment regarding Bank stocks improved over 2013
- Concerns around Bank capitalisation within the Eurozone appear to have receded
- Result of up coming Bank stress tests appears not to weigh on Bank equity currently, with little concern broad equity raising to be required

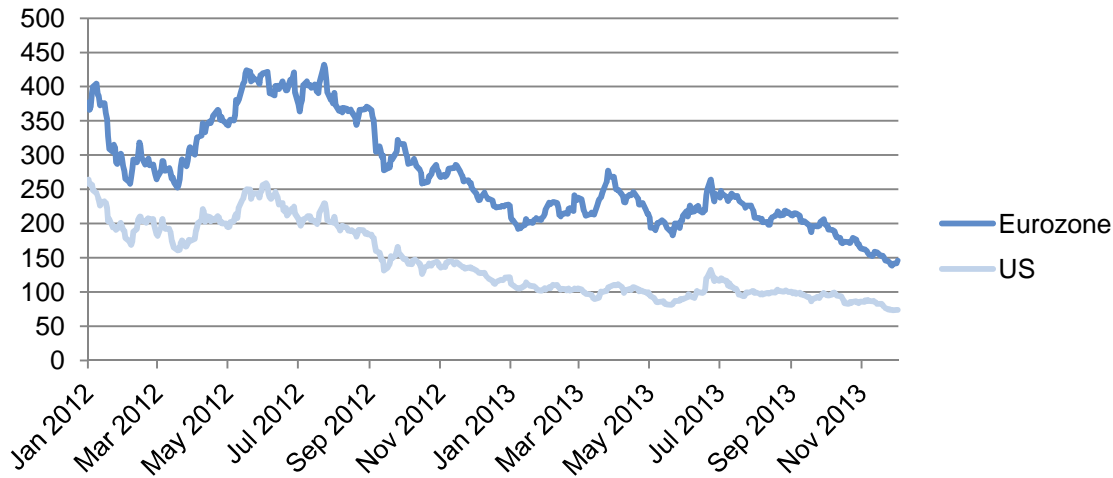
# Convergence in European Banking System



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## Eurozone Bank System is Converging with US Banks

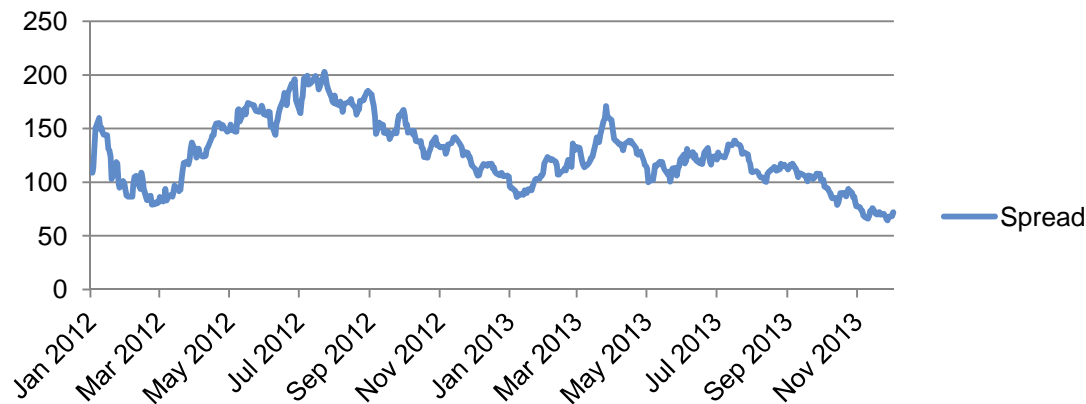
**Bloomberg 'Major' Banks - Eurozone vs US**  
Avg 5y CDS - (bp)



Eurozone bank CDS levels have tightened to their lowest levels for over two years on both an absolute basis and relative to the CDS of US banks.

Eurozone here is average € CDS of :

- UniCredit SpA
- Intesa Sanpaolo SpA
- Banco Bilbao Vizcaya Argentaria SA
- Banco Santander SA
- Commerzbank AG
- Credit Agricole SA
- Societe Generale SA
- BNP Paribas SA
- Deutsche Bank AG
- ING Bank NV
- Dexia Credit Local SA



US is average CDS \$ CDS of :

- Goldman Sachs Group Inc/The
- Morgan Stanley
- Bank of America Corp
- Citigroup Inc
- JPMorgan Chase & Co
- Wells Fargo & Co
- American Express Co



### Banks Deposits and ECB Reliance

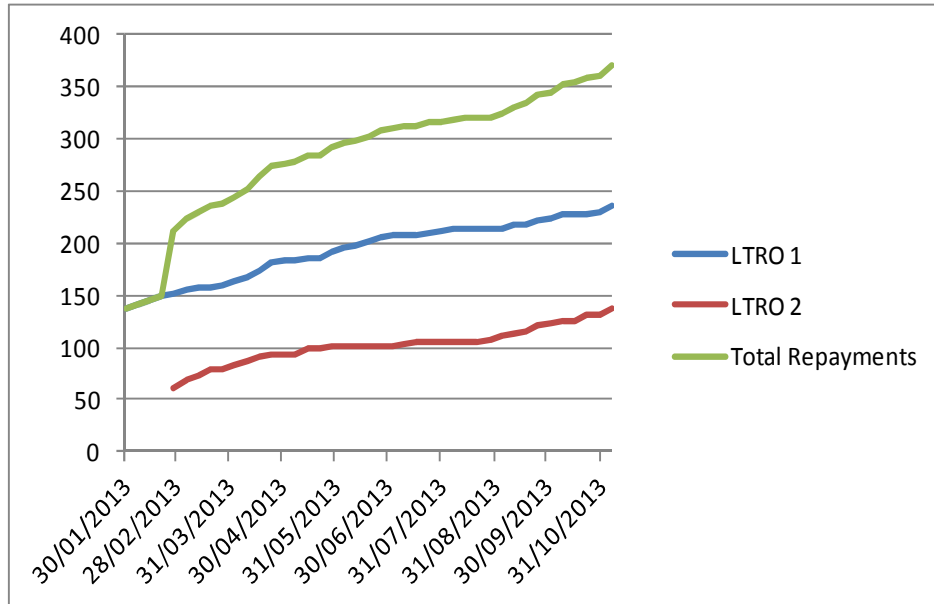
€bn	Target 2 bal.	Target 6m chng	ECB borrowing	Depo 3m chng	Depo 12m chng
Austria	-41	-4	6	0.4%	1.8%
Belgium	-10	6	17	0.5%	5.2%
Cyprus	-8	2	0	-5.5%	-27.8%
Finland	16	-18	2	0.5%	0.1%
France	-53	-7	84	-0.3%	4.2%
Germany	561	-46	9	0.6%	0.6%
Greece	-50	24	62	-1.1%	4.3%
Ireland	-75	11	41	-2.5%	2.6%
Italy	-211	31	230	0.9%	4.2%
Luxembourg	104	1	2	-2.0%	-5.8%
Netherlands	63	-23	11	-0.6%	0.5%
Portugal	-70	-3	51	-0.3%	0.1%
Spain	-264	33	232	0.6%	7.4%

Deposits are non-seasonally adjusted Euro area non-bank, non-government deposits as of Oct 2013. We take total deposits (item 2.2.3, in MFI balance sheets minus “deposits from other financial institutions”, which includes deposits from securitized vehicles and financial holding corporations among others. We also subtract repos (item 2.2.3.4) from the total figures to give a cleaner picture of deposits outside interbank borrowing. ECB borrowing and Target 2 balances are latest available. ECB borrowing is gross borrowing from regular MROs and LTROs.

- Germany’s exposure to the rest of the Target 2 payment system remains large
- Only Cyprus has seen a significant change in its position across the past year

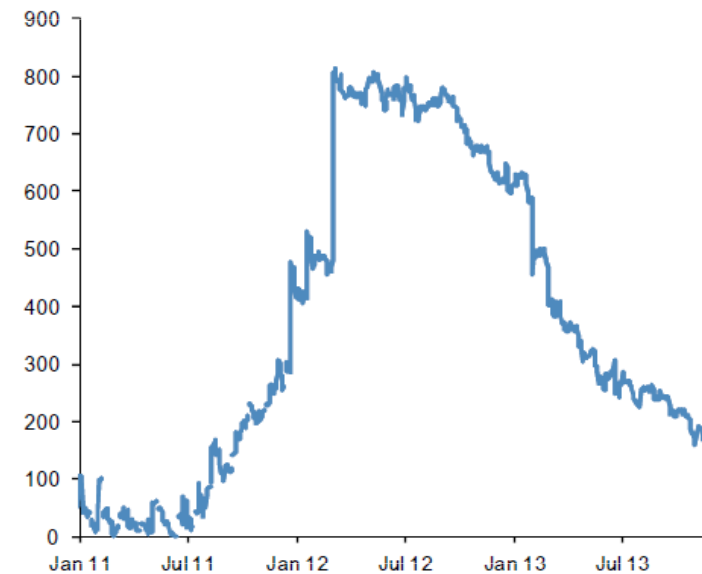
## LTRO Repayment

### LTRO Repayments



### Eurozone Excess Liquidity

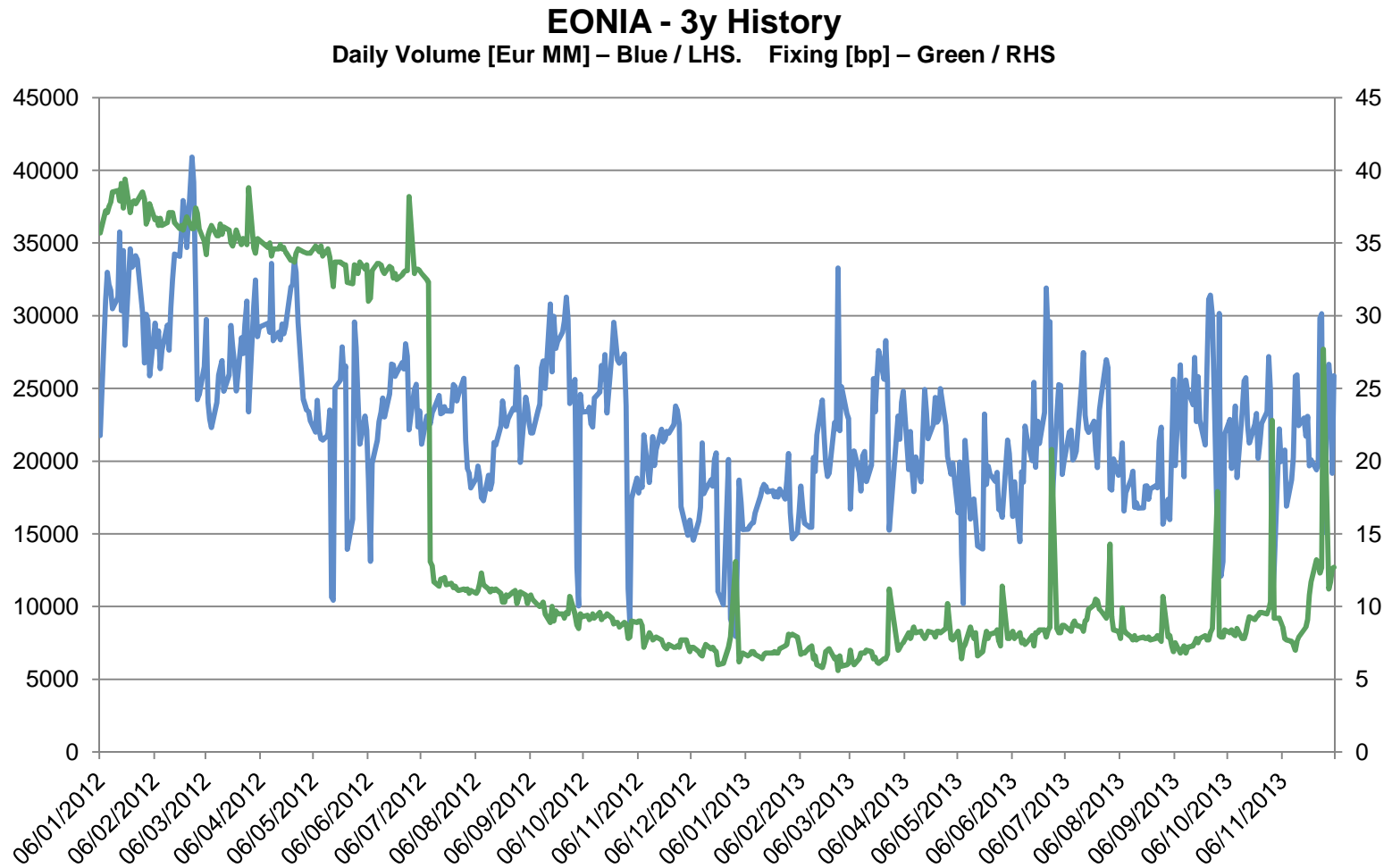
€bn, Measured as the difference between the amount in the ECB deposit facility minus that in the lending facility, plus the difference between the current account reserves that banks hold with the ECB minus required reserves. Last observation is Nov 21, 2013.



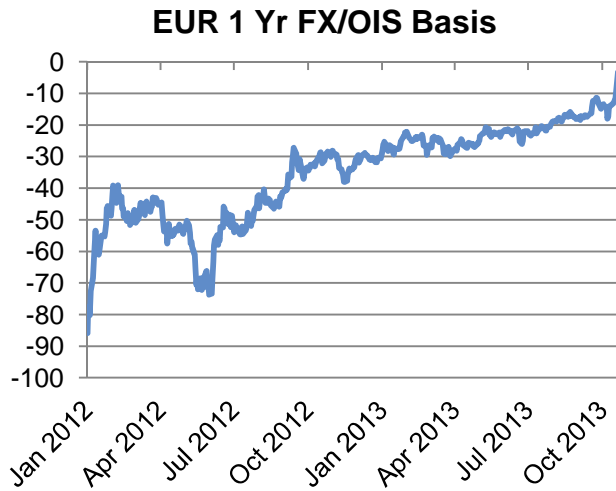
Source: ECB, J.P. Morgan

- LTRO repayments have gradually accumulated, picking up pace over the past quarter.
- The impact of these repayments on the daily Eonia fix however has been muted to date

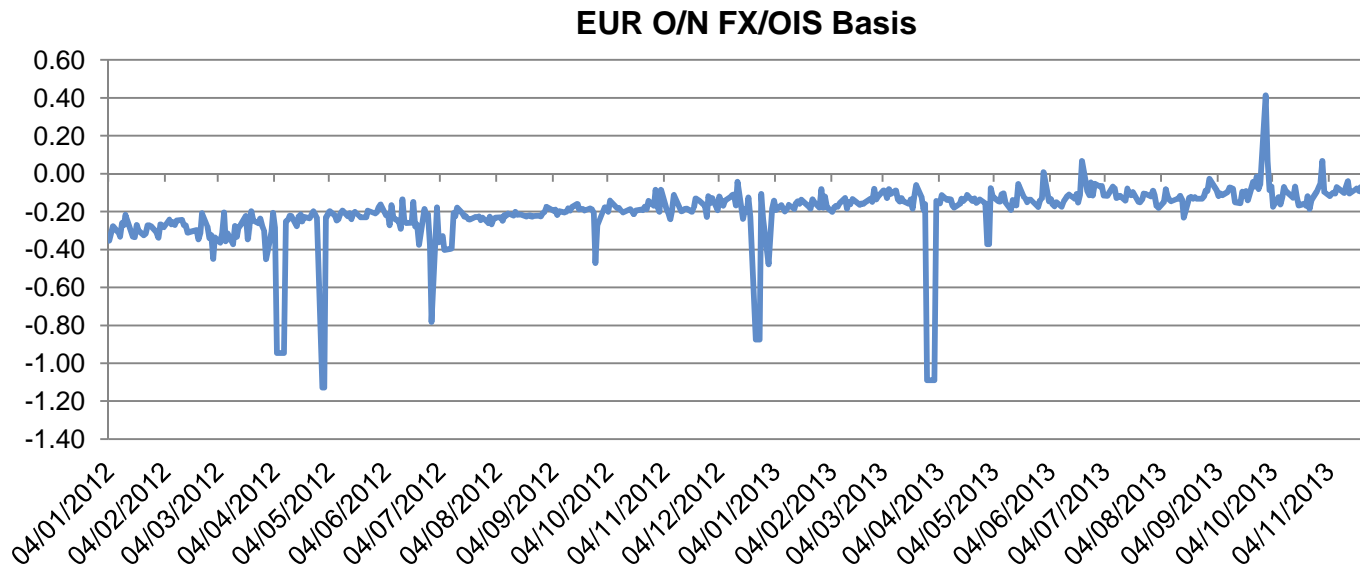
Volumes in the Eonia Market



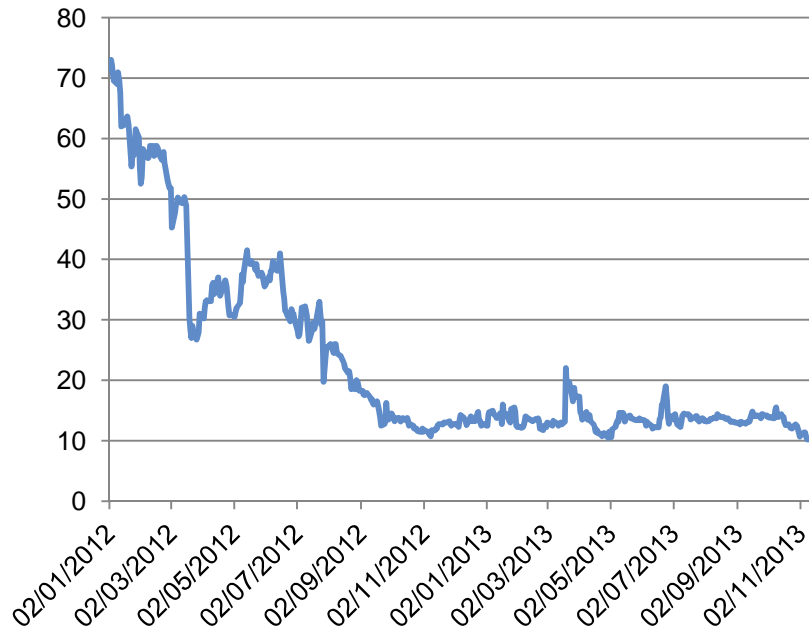
Risk Premium in Eurozone Reducing - cont



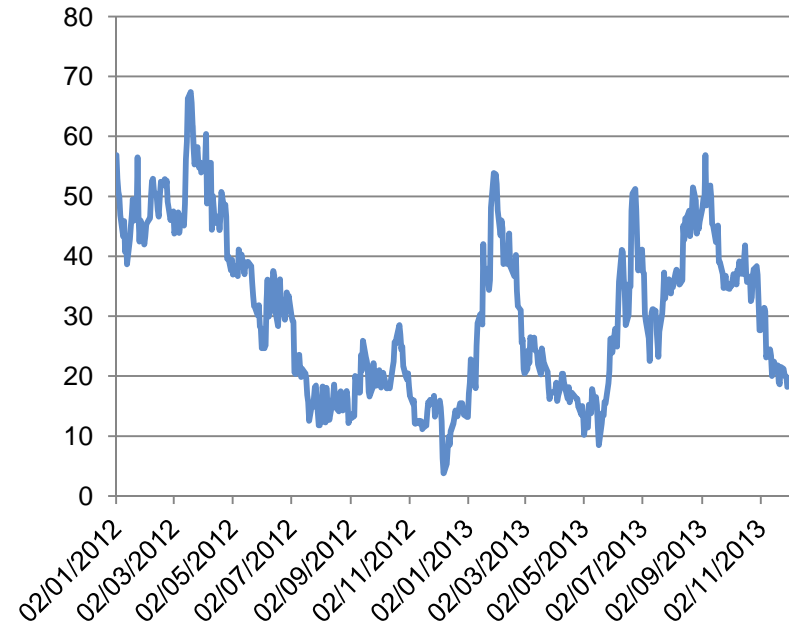
- \$ funding pressures for European Banks easing as USD funding market reopen to European names
- Volatility in short dated fx swap market has significantly reduced from subsequent years
- European Banks taking advantage of the FX Basis leaving additional balances at the Fed



Front FRA Eonia Spread

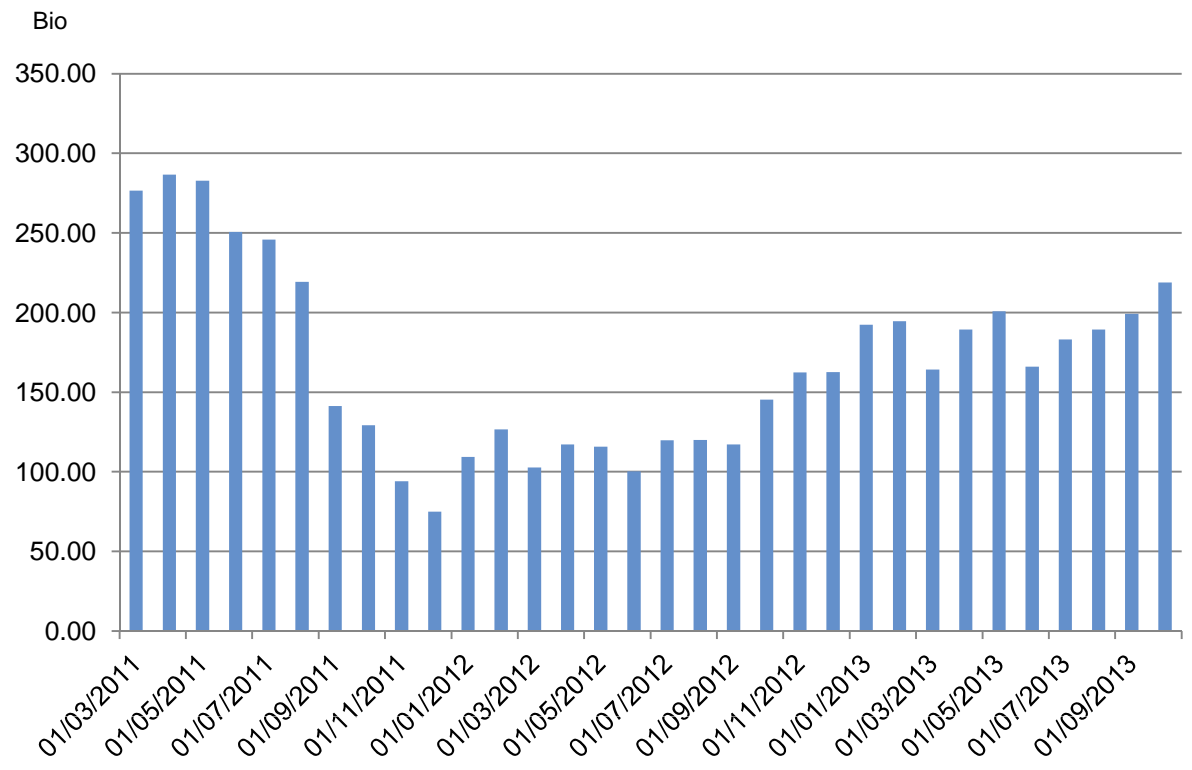


1y1y Fwd Eonia Swaps  
BP

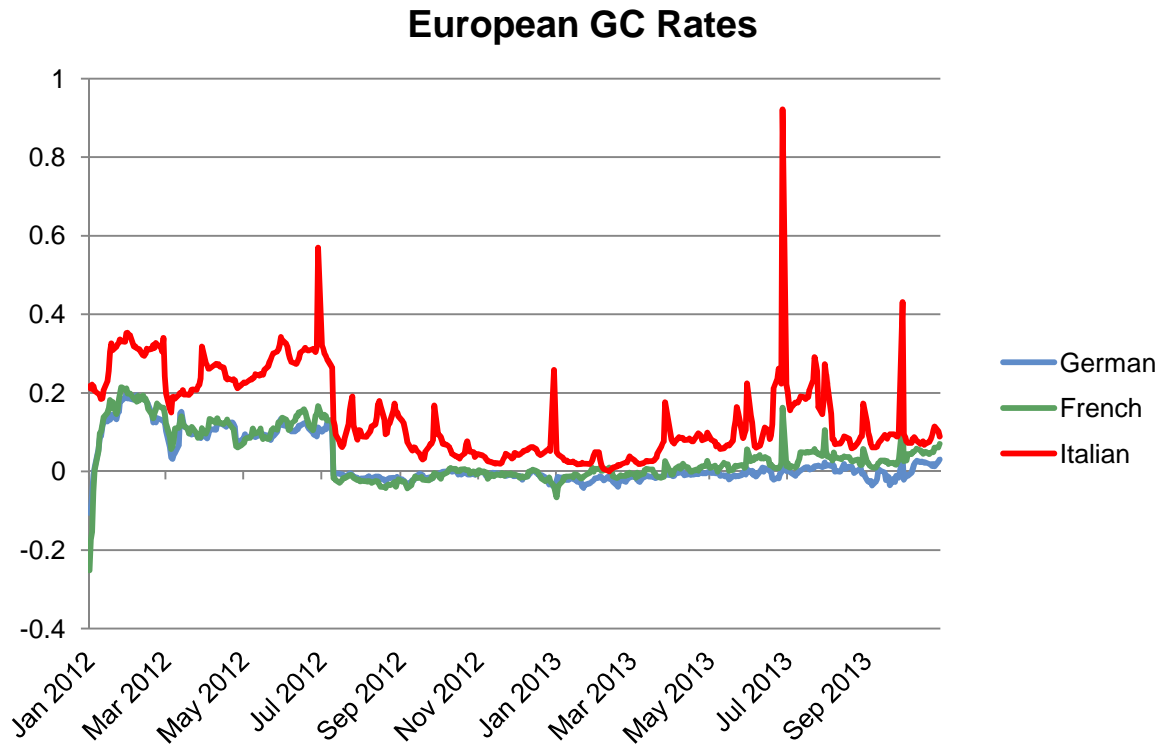


- Risk premium significantly reduced
- ECB's forward guidance failed to prepare the market for November's easing.
- ECB's objective to reassure markets that rates would remain low for a prolonged period now seems to have been achieved

## US Money Market Fund Exposure to French Banks

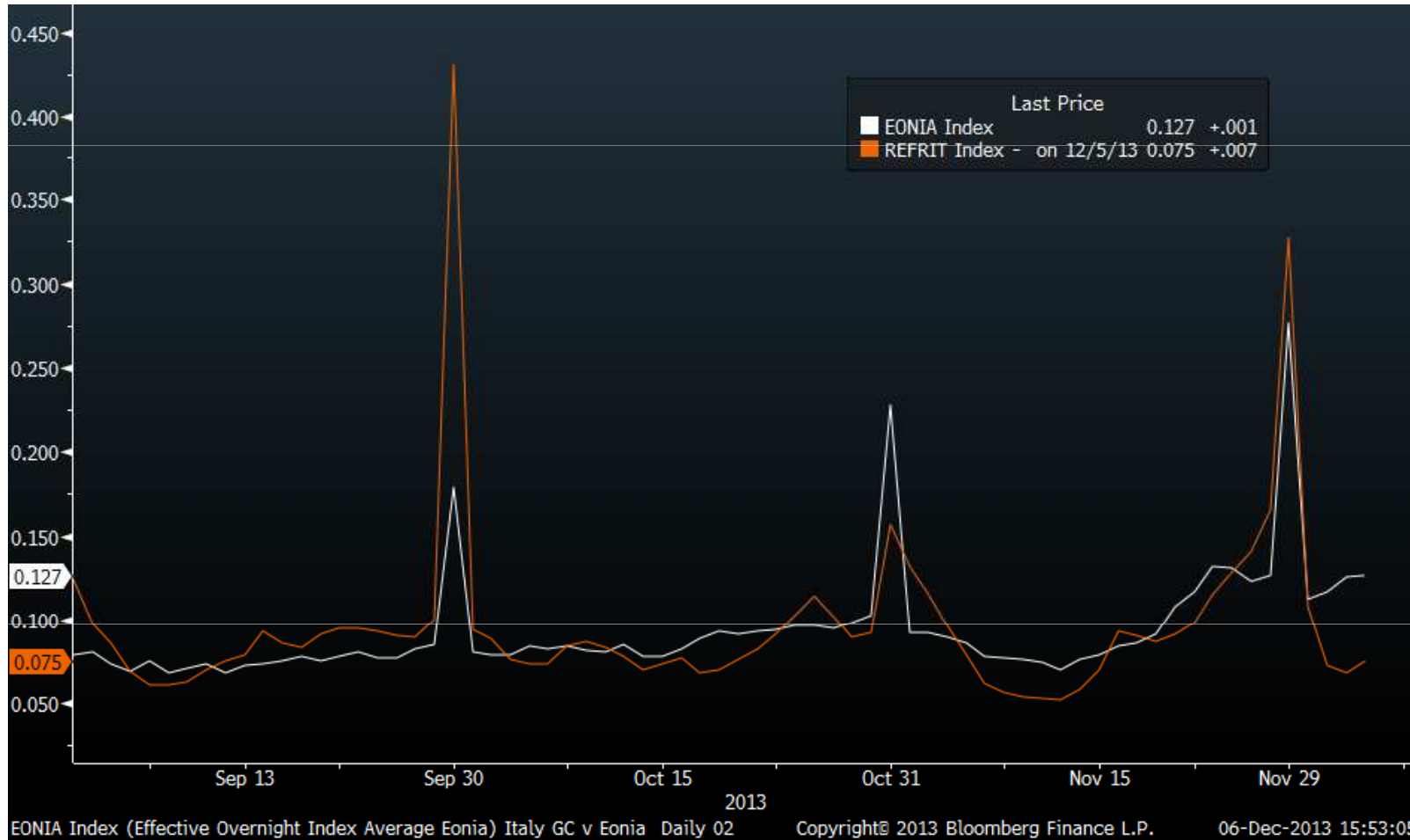


•US Funds gradually increasing exposure to French banks as sentiment improves



- Other than seasonal factors triggering pricing pressure, Italian GC converging on Core Europe
- Market beginning to increasingly differentiate between French and German GC following France's ratings downgrade

### Italian GC against EONIA

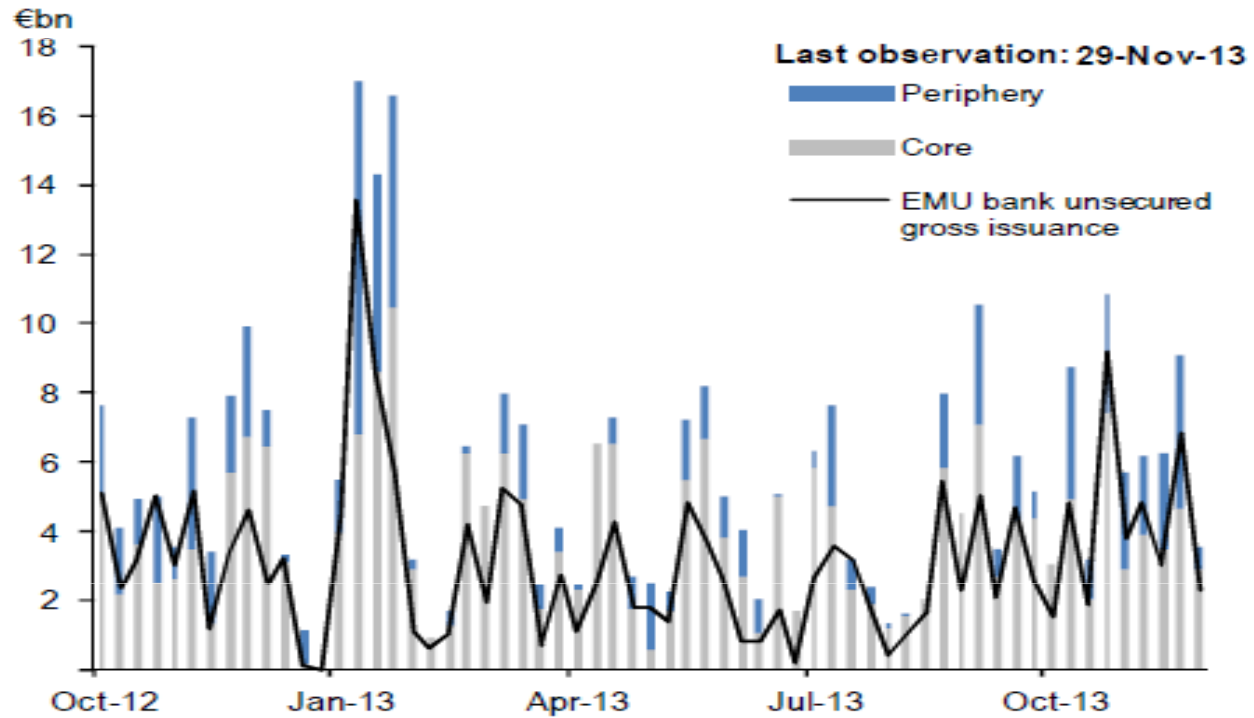


- Divergence of Italian GC away from Eonia rate highlights liquidity squeezes
- What will be the impact of year end on pricing?



### Euro Area Gross Bank Debt Issuance

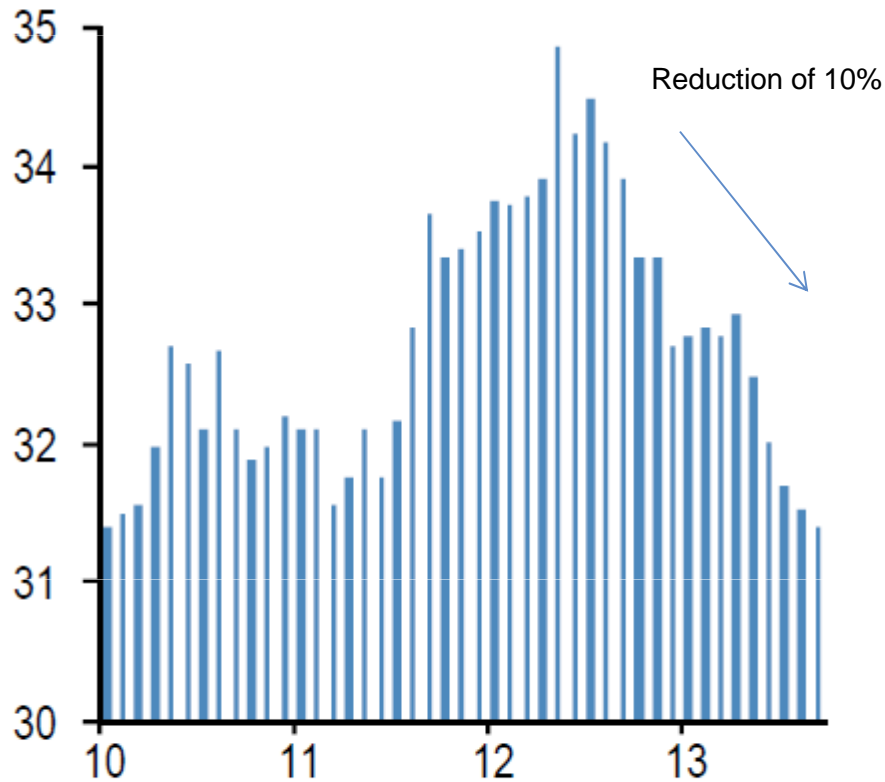
Includes secured, unsecured and securitized issuance in any currency. Excludes short-term debt (maturity less than 1-year) and self funded issuance (where the issuing bank is the only book runner).



Source: Dealogic, J.P. Morgan

## Aggregated Euro Area Bank Balance Sheet

€tr, last obs is for Sep 2013



- Impact of factors such as Leverage Ratio, LCR and upcoming Eurozone Bank Stress Tests behind motivation for banks to reduce Balance Sheet

- LTRO 400bio
- Interbank 400bio
- Derivatives 1.5 trillion
- Non resident holdings in European Banks 500bio

- 3.5trillion reduction from peak, of which 2.6trillion driven by 'core' Europe banks

- 30% Balance sheet to support Euro Area real economy (50% in the US) = Balance sheet reduction trend to continue

Source: ECB

- What options are open to the ECB?
- Regarding the ECB policy rate, options for the ECB could involve
  1. Taking the deposit facility rate negative, potentially in increments of less than 25bps
  2. Narrowing the corridor between the MRO rate and the deposit facility rate to zero
- While the system is technically ready, will there be an adverse impact on funding markets and what does that mean for Bank dependency on LTRO funding
- Liquidity focused measures could include
  1. Introduction of QE
  2. Reduction in Reserve Requirements
  3. Abolition of the Bond Purchase Sterilization Program
  4. Introduction of additional LTROs