

Monetary policy outlook for December 2020 and the following year, amid the recent commitment of ECB President's to recalibrate the policy tools, and expected effects on the money markets.

Monetary policy outlook

ECB Meeting 29 October 2020 , Introductory Statement

“The new round of Eurosystem staff macroeconomic projections in December will allow a thorough reassessment of the economic outlook and the balance of risks. On the basis of this updated assessment, the Governing Council will recalibrate its instruments...”

ECB Forum on Central Banking 11 November 2020, President Lagarde

“While all options are on the table, the PEPP and TLTROs have proven their effectiveness in the current environment and can be dynamically adjusted to react to how the pandemic evolves. They are therefore likely to remain the main tools for adjusting our monetary policy.”

Monetary policy outlook

Instruments:

- Rate adjustment on conventional tools (DFR, MLF, MRO)
- Minimum Reserve & Tiering factor
- Forward guidance & yield curve control

- Purchasing programs (APP, PEPP)
- TLTRO, PELTRO

Deposit facility rate

- Market expectations range between 0 and 10 bps cut
- Consensus is no change as the advantages of a further cut are seen very limited while it would result in a huge negative impact on the banking sectors profitability
- Especially for retail banks which are unable to pass on negative rates to their client deposits, for competitive, political and legal reasons
- Consensus is as well that if a rate cut of the deposit facility rate is delivered it will be part of a larger package and the tiering factor will be increased
- A deposit rate cut would shift the whole €STR and EURIBOR curve nearly 1:1 in the same direction. Also the short term euro government yields would shift downward.

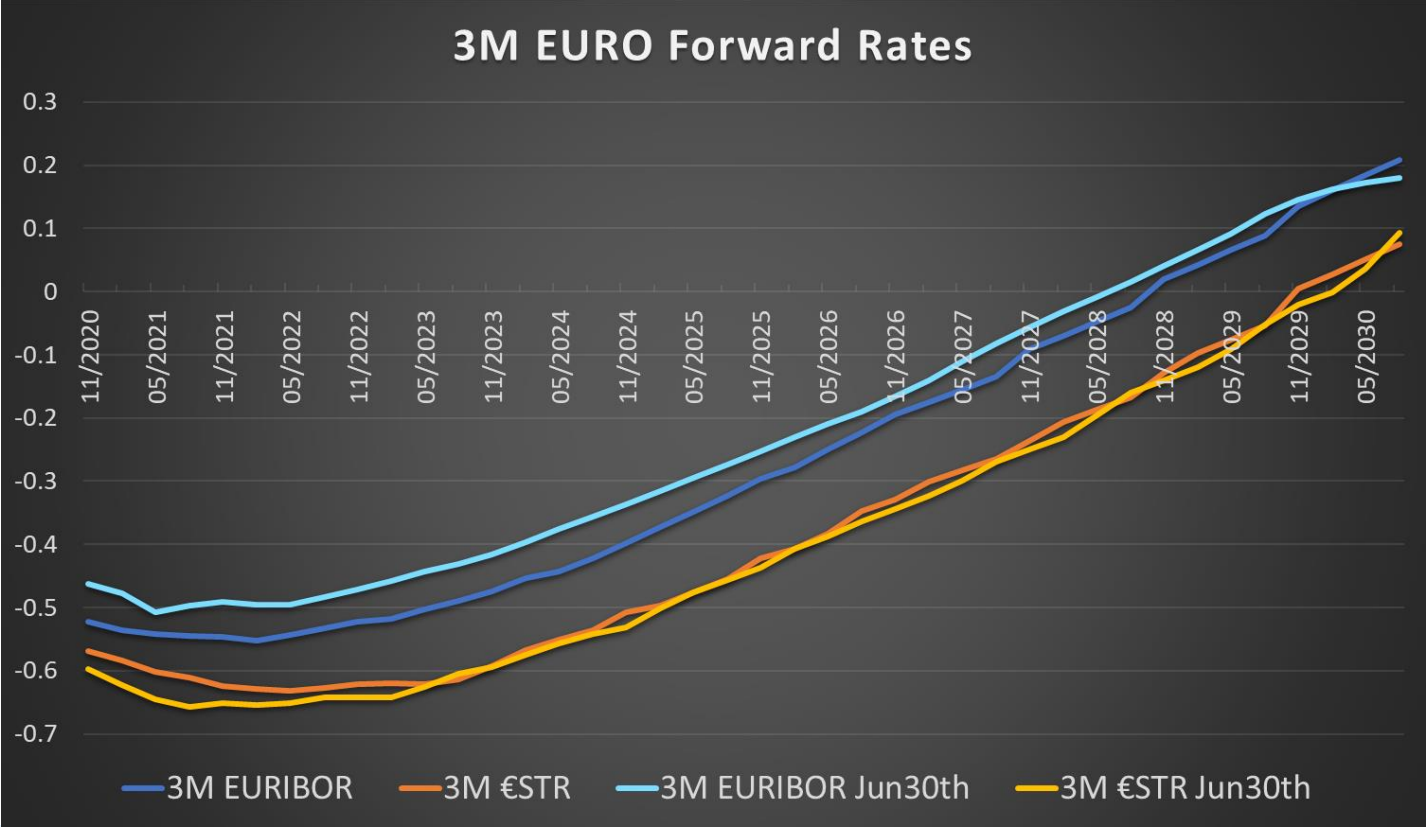
Forward Guidance

Current guidance:

“interest rates will remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon”

- Consensus is no adjustment to forward guidance in the December meeting
- Some market participants expect a change from “close to but below 2% within our projection horizon” to “inflation around 2%, over the medium term”. This would theoretically raise inflation expectations in the future but no immediate market reaction expected
- Timing is important when using this tool
 - *BOE'S RAMSDEN SAYS FORWARD GUIDANCE MORE IMPORTANT IN RECOVERY (BBG Flash News, 17th of November 2020)
 - The Federal Reserve's forward guidance will be “particularly powerful” as the economy comes back. (Robert Kaplan)

Market expectations - Rates



Source: ERSTE

Market expectations – GC Pooling Rates



Source: Bloomberg

Market expectations - Inflation



Source: Bloomberg

Minimum reserve & Tiering

- Although some market participants see the possibility that the remuneration rate for minimum reserves and tiering exemption could be adjusted, the broad consensus is a unchanged rate.
- Regarding the tiering factor consensus is and increase towards 8x-10x the MR requirement, but some market participants expect a change even up to 12x the MRR.
- An increase in the tiering factor could offset, at least partially, negative effects of an expansion of TLTROIII / PEPP or a DFR cut without impacting balance sheet or collateral base of the banks.
- An increase in the tiering multiplier to 10x MRR would reduce excess liquidity from €3.3 trillion to about €2.8 trillion. This remains more than sufficient to ensure that short term rates are not impacted.
- If ECB aims to intensify more cross-border money market activities, then the factor should be increased to more than 12x MRR.