

Review of recent developments in money markets

June 2023

Market expectations for the ECB monetary policy decisions | Reaction to the previous hikes and pass through

16 March (+50bp, DFR @ 3.00%): separation principle = hawkish surprise

The decision to maintain the 50bp/meeting hiking pace despite the ongoing turmoil related to the US financial sector was seen by the market as a clear signal that any possible measures to guarantee financial stability would not affect Monetary policy decisions in the Eurozone.

Rate hike expectations immediately increased and the swap curve bear steepened, led by the long end.

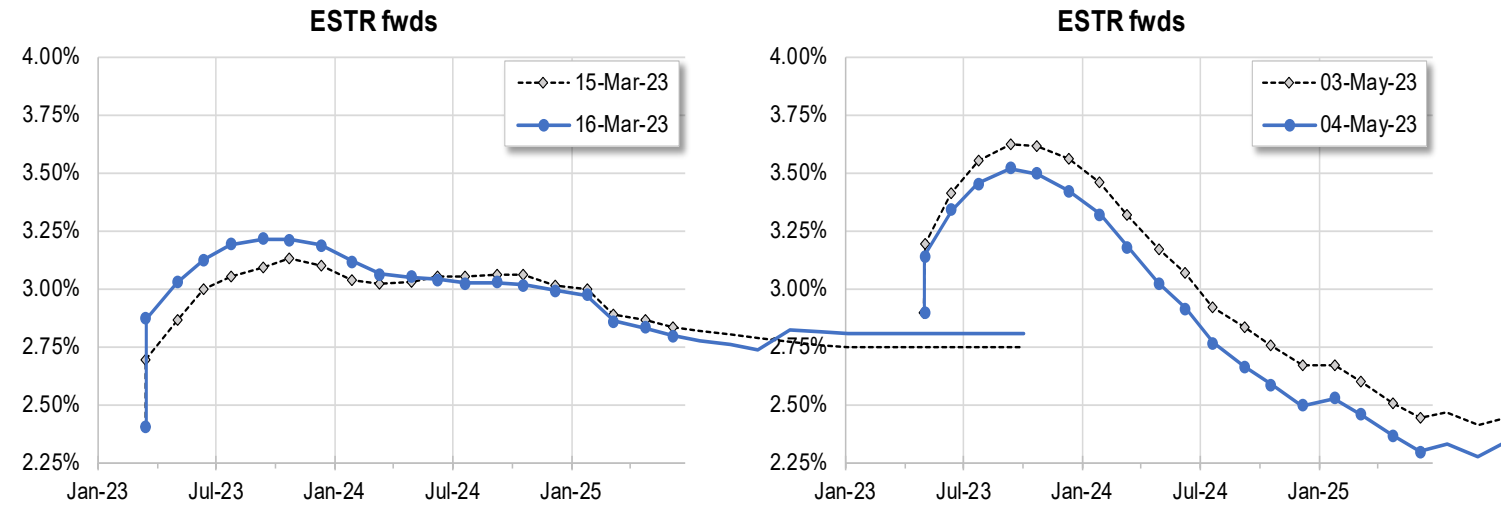
4 May (+25bp, DFR @ 3.25%): slowdown = dovish surprise

Despite the announcement to step up the APP QT from July, the decision to slow down the pace of hikes to 25bp/meeting was read by the market as a dovish sign.

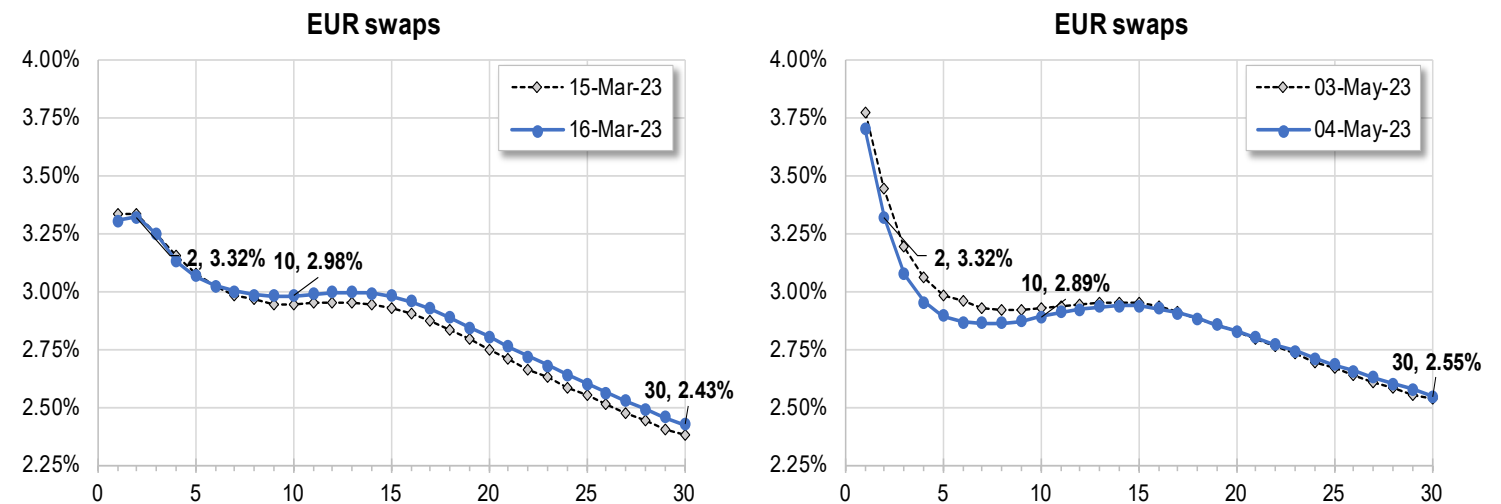
Rate hike expectations immediately decreased and the curve bull steepened, led by the front end.

Passthrough of rate hikes to the unsecured and secured money markets have been almost immediate.

€STR fwds corresponding to ECB meetings



EUR swap (vs. 6m Euribor) curves



Market expectations for the ECB monetary policy decisions | Reaction to the 15 June meeting

15 June 2023 – ECB meeting

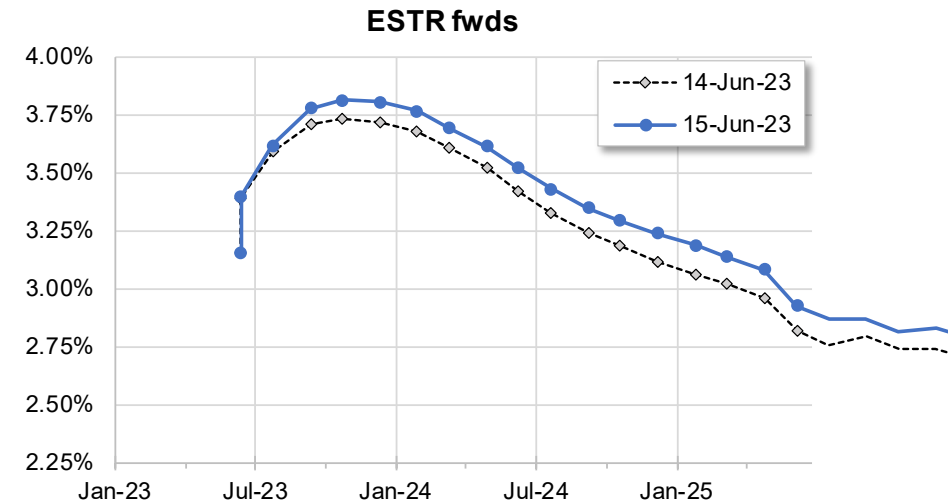
The ECB hiked official rates by 25bp, taking the DFR to 3.5%, and introduced no changes to its QT plans (APP reinvestments to be halted from 1 July, PEPP reinvestments to continue until at least end-2024) nor its liquidity facilities.

With the market expecting this move, we think the most interesting aspects of the ECB meeting were:

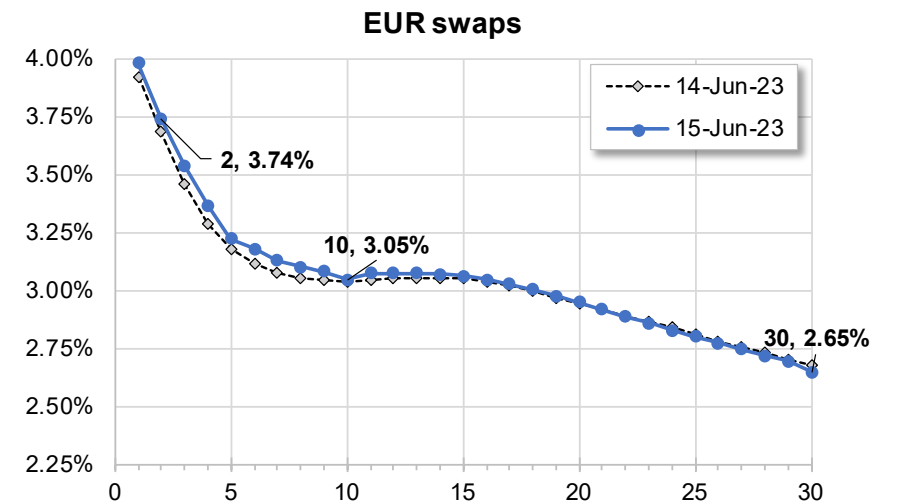
- The upward revision to expected inflation: in the new staff macro projections, the ECB marginally raised its headline inflation forecasts (+0.1%) for the whole forecast horizon (2023 to 2025), but more importantly it raised its core inflation forecast for 2024 to 3.0% from 2.5% in March.
- In the Q&A session, Lagarde reiterated that the ECB is not about to pause in its hiking cycle (“the journey is not over/not yet at destination”), as the ECB still has ground to cover, adding that it is “very likely” the Bank will hike again next month.

The knee-jerk market reaction repriced expectations for rate hikes, with the market pricing in a terminal DFR above 3.75% and rate cuts now delayed until the March 2024 meeting.

€STR fwds corresponding to ECB meetings



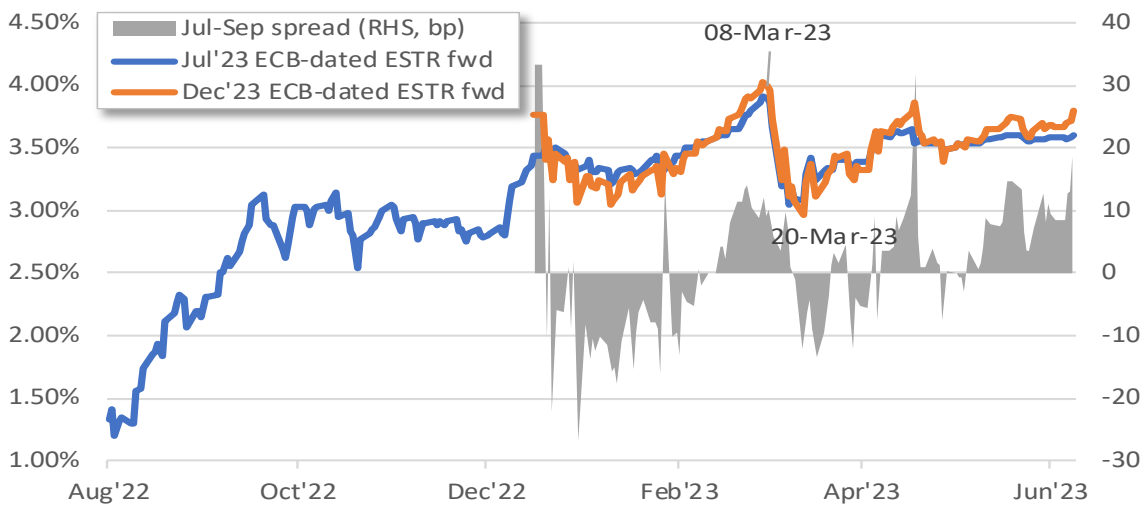
EUR swap (vs. 6m Euribor) curves



Sources: Bloomberg

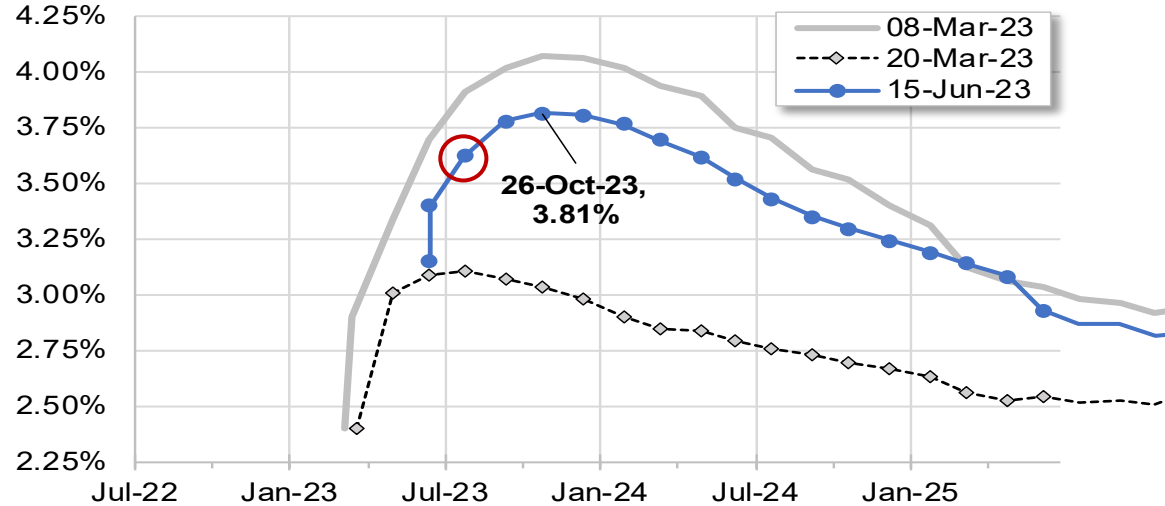
Market expectations for the ECB monetary policy decisions | Expectations for July + forthcoming measures

Evolution of expectations for Jul'23 ECB-dated €STR



Source: Bloomberg

€STR fwds corresponding to ECB meetings



Source: Bloomberg

Official rates: The market is currently pricing in c.90% probability of another 25bp hike to be delivered in July. Then, the market foresees a c.50% probability of a final 25bp hike being delivered in September, hence reaching a terminal DFR of 4.00%. Chances of rate cuts are priced in from March 2024 onwards.

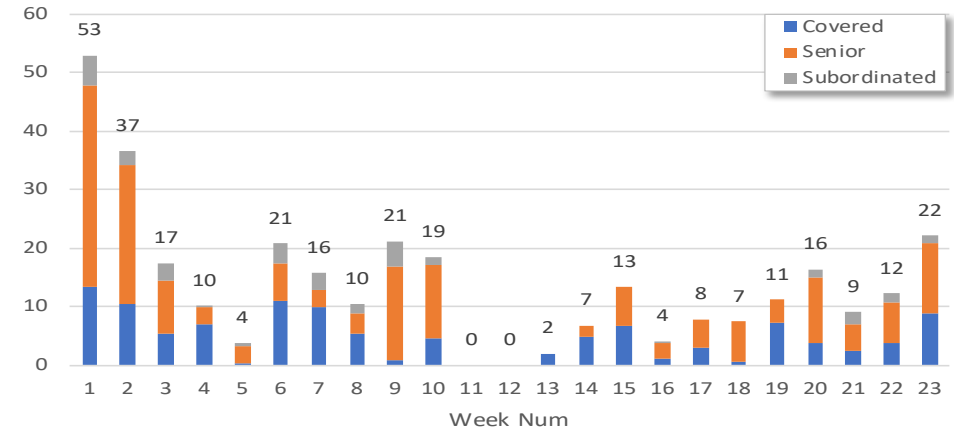
Liquidity Facilities after the TLTRO: The market is not expecting any new liquidity facilities.

Quantitative Tightening: Passive QT involving just the APP seen as most likely scenario still for several months. PEPP unlikely to be included at least until the first rate cuts are needed (anti-fragmentation) with most players expecting Dec24.

Access to primary markets:

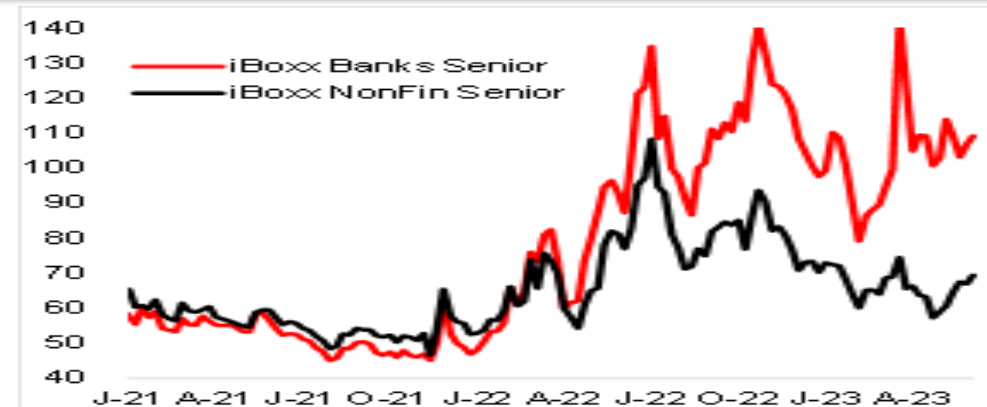
- Barring a two-week blackout at the very beginning of the US financial system turmoil, **European banks continue to have access to the primary market.**
- In terms of amounts:
 - ✓ **Average weekly issuance** is now again at the same levels than in the 5 weeks preceding the SVB event ...
 - ✓ ... and we have even seen **subordinated issuance resuming** over the past few weeks.
- In terms of spreads:
 - ✓ Spreads widened to quickly unwind half the move, standing at its **14month average**
 - ✓ ... with the gap over the non-financial corporates slightly wider

European banks – Weekly issuance in 2023 (€ bn)



Source: BondRadar, Bloomberg

iBxxx Banks vs NonFin Senior – Spread performance (bp)

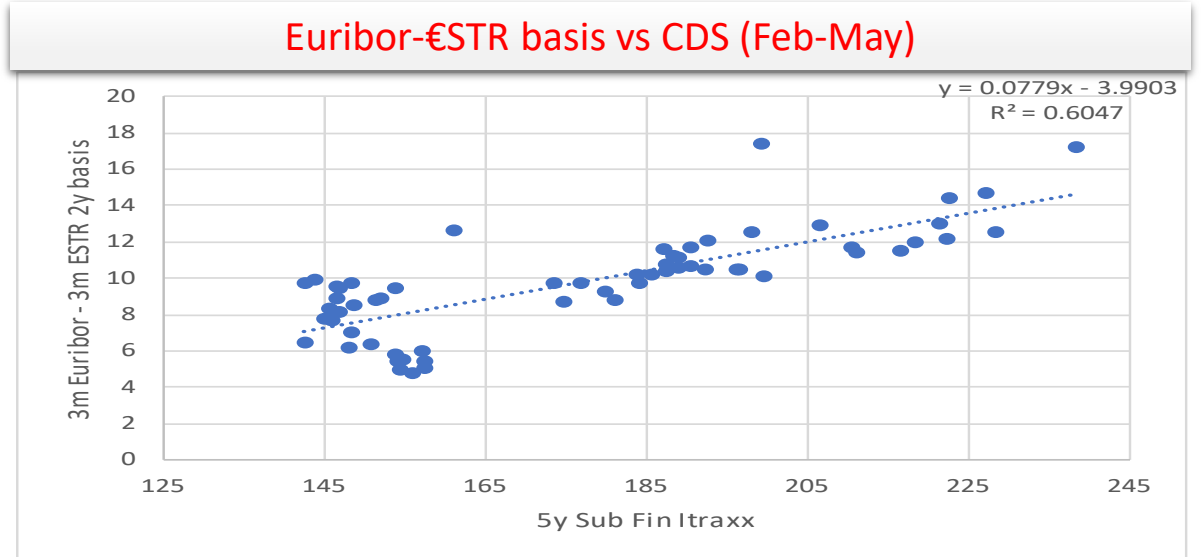


Source: IHS Markit

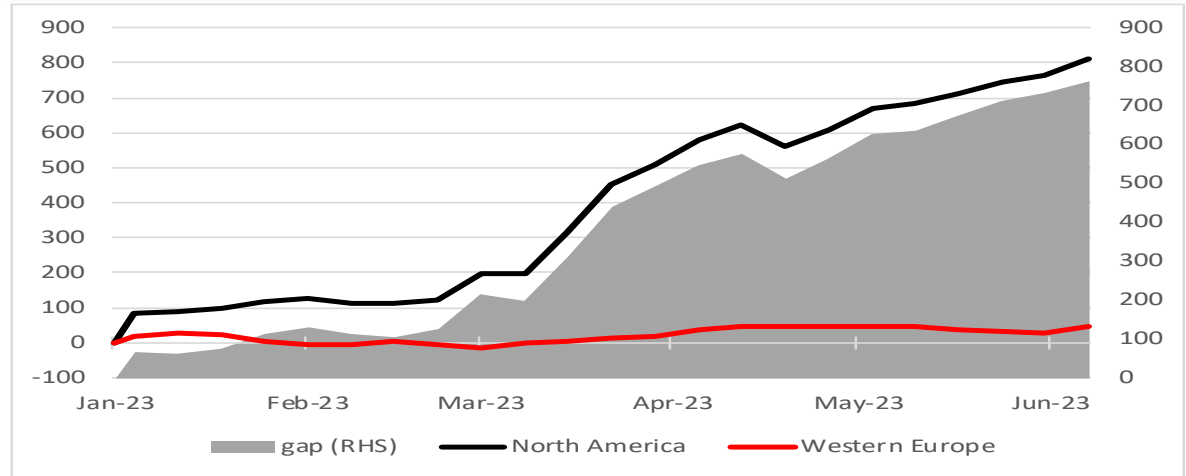
US regional bank turmoil | Spillover into Euro area bank funding

Withdrawal of deposits, apparently more related to pricing than to credit concerns:

- April saw a sizable net increase in household deposits in the Eurozone, offsetting the withdrawals seen in the previous two months. Not all countries evolved in the same way.
- Flows into Money Market Funds is nowhere near to those seen in the US. That said, there is evidence of an increased demand for sovereign debt by retail investors – mostly a matter of yield search



Money Market Funds – Flows during 2023 (YtD, \$ bn)



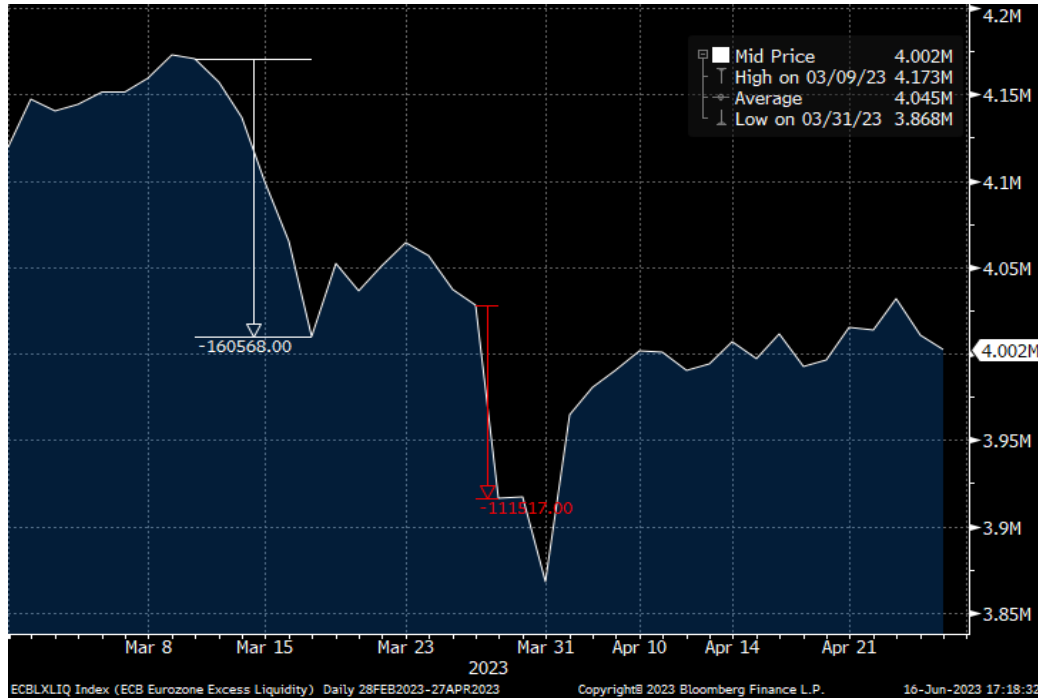
Flow of Household Deposits – EUR bn and % of total deposits

	EuroArea	Germany	France	Italy	Spain	Portugal
Apr-23	29.0 0.3%	15.5 0.6%	4.6 0.2%	2.5 0.2%	0.6 0.1%	-0.4 -0.3%
Mar-23	-19.1 -0.2%	-14.4 -0.5%	10.8 0.6%	-14.5 -1.1%	-3.2 -0.3%	-3.0 -1.7%
Feb-23	-10.3 -0.1%	0.3 0.0%	2.9 0.2%	-5.9 -0.5%	-4.8 -0.5%	-2.1 -1.1%
Jan-23	0.6 0.0%	-8.5 -0.3%	2.1 0.1%	-4.8 -0.3%	-13.1 -1.3%	-2.5 -1.4%
Dec-22	84.3 0.9%	11.5 0.4%	20.7 1.1%	16.4 1.3%	14.1 1.4%	0.2 0.1%
Nov-22	-9.6 -0.1%	12.8 0.5%	-3.1 -0.2%	-14.3 -1.1%	2.8 0.3%	0.2 0.1%
Oct-22	-14.4 -0.2%	3.2 0.1%	-10.7 -0.6%	-2.2 -0.2%	-5.1 -0.5%	0.8 0.4%
Sep-22	15.9 0.2%	4.6 0.2%	6.2 0.3%	-2.2 -0.2%	-1.1 -0.1%	-0.1 -0.1%
Aug-22	-16.0 -0.2%	-2.6 -0.1%	1.3 0.1%	-5.8 -0.4%	-3.9 -0.4%	-1.3 -0.7%
Jul-22	61.8 0.7%	21.5 0.8%	18.4 1.0%	11.3 0.9%	2.5 0.2%	2.4 1.3%
2023 YTD	0.1 0.0%	-7.1 -0.3%	20.4 1.1%	-22.2 -1.7%	-20.5 -2.1%	-8.1 -4.4%
since Aug-22	122.0 1.3%	43.8 1.6%	53.3 2.8%	-18.4 -1.5%	-11.2 -1.1%	-5.9 -3.3%

Source: ECB

US regional bank turmoil | Impact on excess liquidity

Evolution of excess liquidity



Source: Bloomberg

Evolution of ECB liabilities

ECB BS (Liabilities)	10-Mar	17-Mar	24-Mar	31-Mar	07-Apr	14-Apr	21-Apr
1 Banknotes in circulation	1,553	1,554	1,553	1,557	1,564	1,561	1,559
2 Liabilities to euro area credit institutions related to monetary policy operation	4,337	4,176	4,224	4,034	4,168	4,173	4,182
2.1 Current accounts (covering the minimum reserve system)	177	235	175	197	159	156	165
2.2 Deposit facility	4,158	3,940	4,048	3,837	4,009	4,017	4,016
2.3 Fixed-term deposits	0	0	0	0	0	0	0
2.4 Fine-tuning reverse operations	0	0	0	0	0	0	0
2.5 Deposits related to margin calls	1	1	1	0	0	0	0
3 Other liabilities to euro area credit institutions denominated in euro	30	34	37	61	36	35	32
4 Debt certificates issued	0	0	0	0	0	0	0
5 Liabilities to other euro area residents denominated in euro	445	570	510	497	442	447	442
5.1 General government	355	425	418	401	351	357	355
5.2 Other liabilities	90	145	92	96	92	90	87
6 Liabilities to non-euro area residents denominated in euro	275	305	317	357	306	298	287
7 Liabilities to euro area residents denominated in foreign currency	10	10	11	11	11	12	12
8 Liabilities to non-euro area residents denominated in foreign currency	5	5	5	5	5	5	5
8.1 Deposits, balances and other liabilities	5	5	5	5	5	5	5
8.2 Liabilities arising from the credit facility under ERM II	0	0	0	0	0	0	0
9 Counterpart of special drawing rights allocated by the IMF	182	182	182	180	180	180	180
10 Other liabilities	282	284	287	284	275	277	273
11 Revaluation accounts	589	589	589	622	622	622	622
12 Capital and reserves	121	121	121	120	120	120	120
Total liabilities	7,829	7,832	7,836	7,730	7,729	7,731	7,714

Source: ECB