



DZ BANK
Die Initiativbank

ECB MMCG - Money Market Contact Group

Wednesday, 20th September 2023
2pm – 4.30pm CET

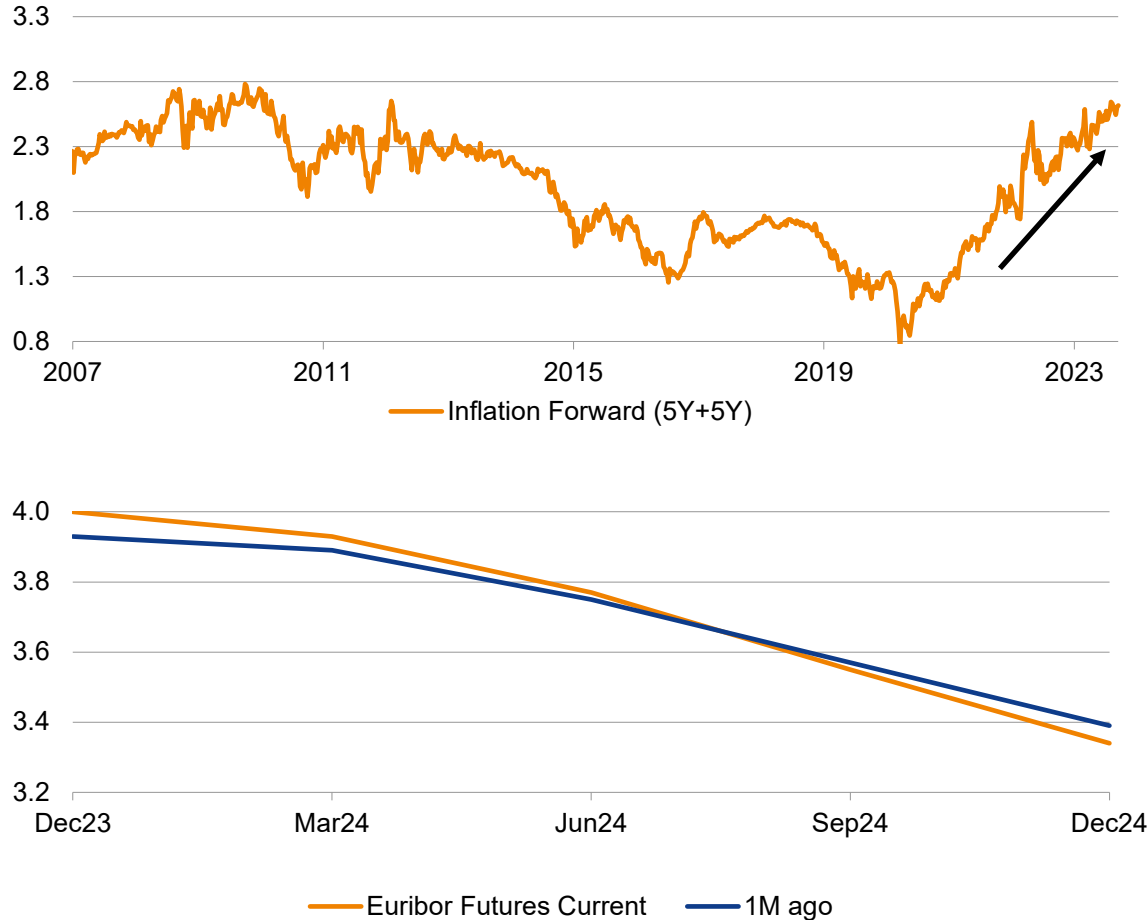
DZ BANK AG Frankfurt, Group Treasury, Oliver Deutscher

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Peak in the rate hike cycle probably reached



Development of inflation expectations worrisome

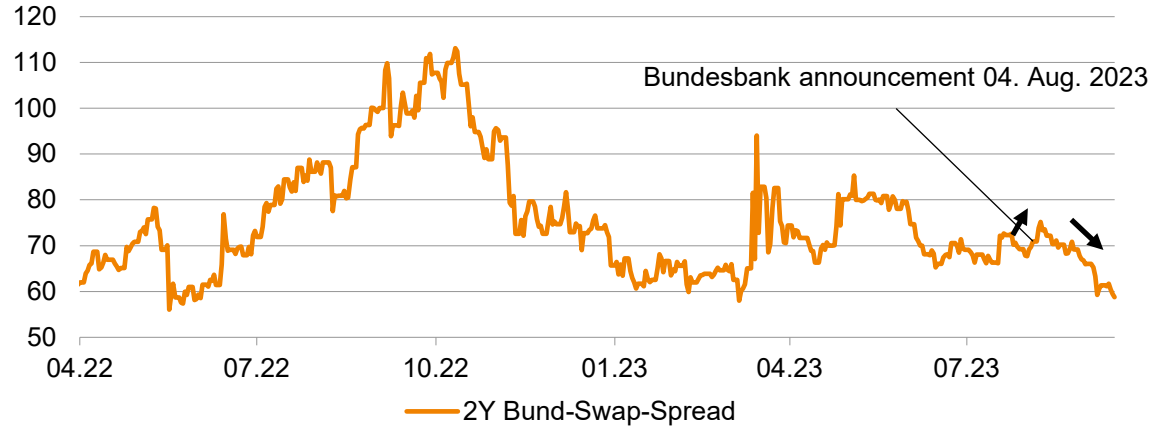


- Sentiment indicators point to a loss of momentum in the European economy. Headline inflation recedes. But core inflation rate proves to be quite stubborn. Somewhat worryingly in the current environment, longer-term inflation expectations continue to trend upwards.
- Market expectations (WIRP) suggest that the peak in the rate hike cycle has probably been reached. We expect the ECB to maintain its restrictive key interest rates for some time to come. A first cautious loosening of the interest rate reins seems conceivable in autumn 2024.
- Reduction of the monetary policy stimulus through an adjustment of the forward guidance of the PEPP. We favour a shortening of the forward guidance period. PEPP reinvestments could be completed in June instead of December. A gradual reduction of reinvestments in advance (like APP)
- „Markets view“ and possibility of additional factors adding on interest rate expectations as i.e.:
- Maturities TLTRO's in 2024
- Open discussions on ACC/ Credit-Claims refinancing maturity buckets > 1 yrs. (i.e.: NSFR) horizon
- Lingering further regulatory restrictions on liquidity ratios and accountability of current stable funding sources

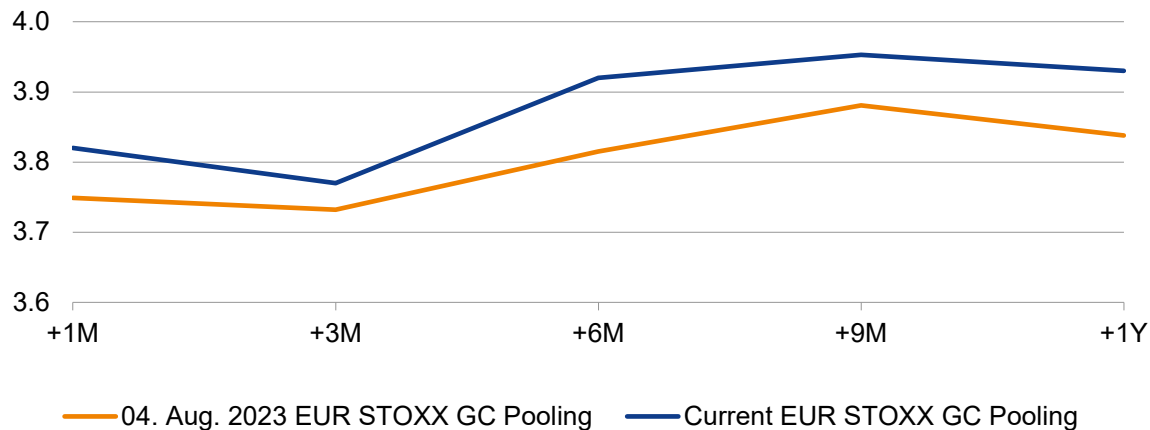
We do not anticipate renewed scarcity concerns



Finished APP Reinvestments / Higher Borrowing by the Finanzagentur



- Following the Bundesbank's announcement that it would no longer pay interest on domestic government deposits, the 2Y Bund swap spread temporarily widened somewhat.
- On the market side, there were fears that liquidity could be shifted into short-dated German government paper.
- The pronounced scarcity concerns from last year are not expected to be repeated. Thus, public deposits at the Bundesbank have melted down to only about 35 billion euros. (Reference Date 4. August)
- Other factors that speak against an excessive widening of the 2Y Bund swap spread is the fact that the ECB has in the meantime ended its APP reinvestments. Moreover, the planned higher borrowing by the Federal Republic should counter concerns about a shortage of German Government securities.
- We expect the Bund swap spread to tend to tighten in the coming months.
- The remuneration of government deposits on one side and the sharp rise in the front-end money market interest rates, were leading and motivating absent investors (i.e. municipalities) back into money markets
- A scarcity in collateral or repo markets could not be seen, vice versa good additional liquidity, market depth and flows could be seen over the last month.

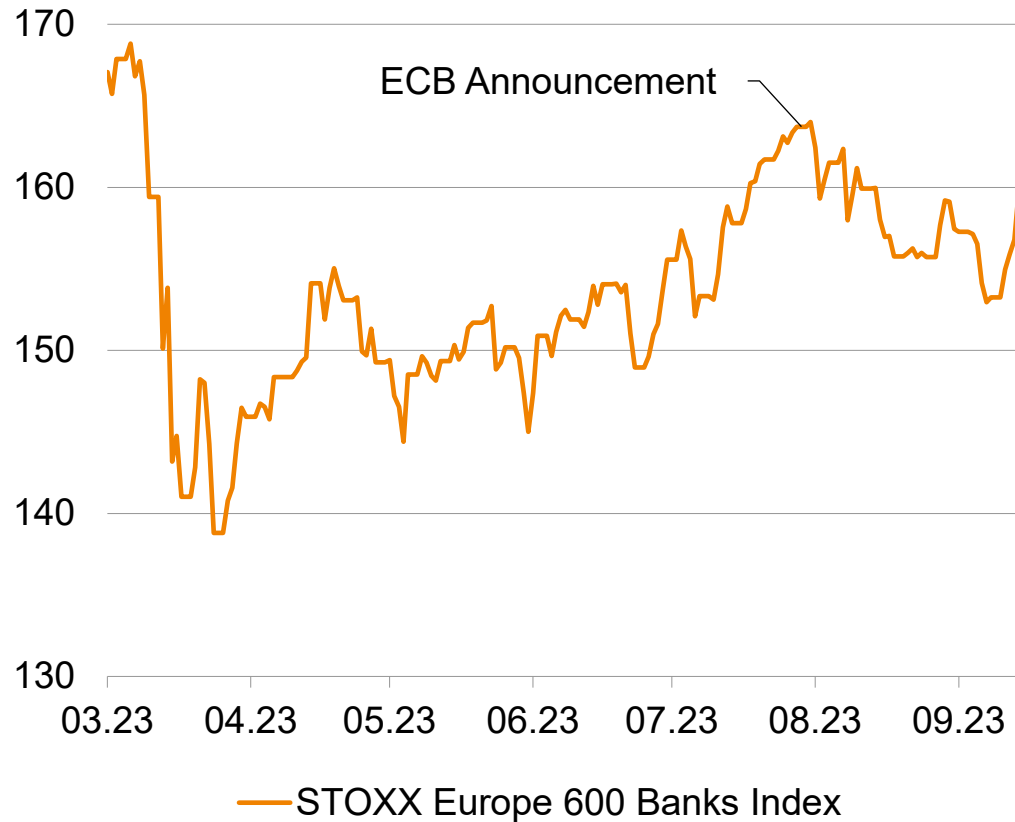


ECB adjusts remuneration of MRR reserves – Now 0%

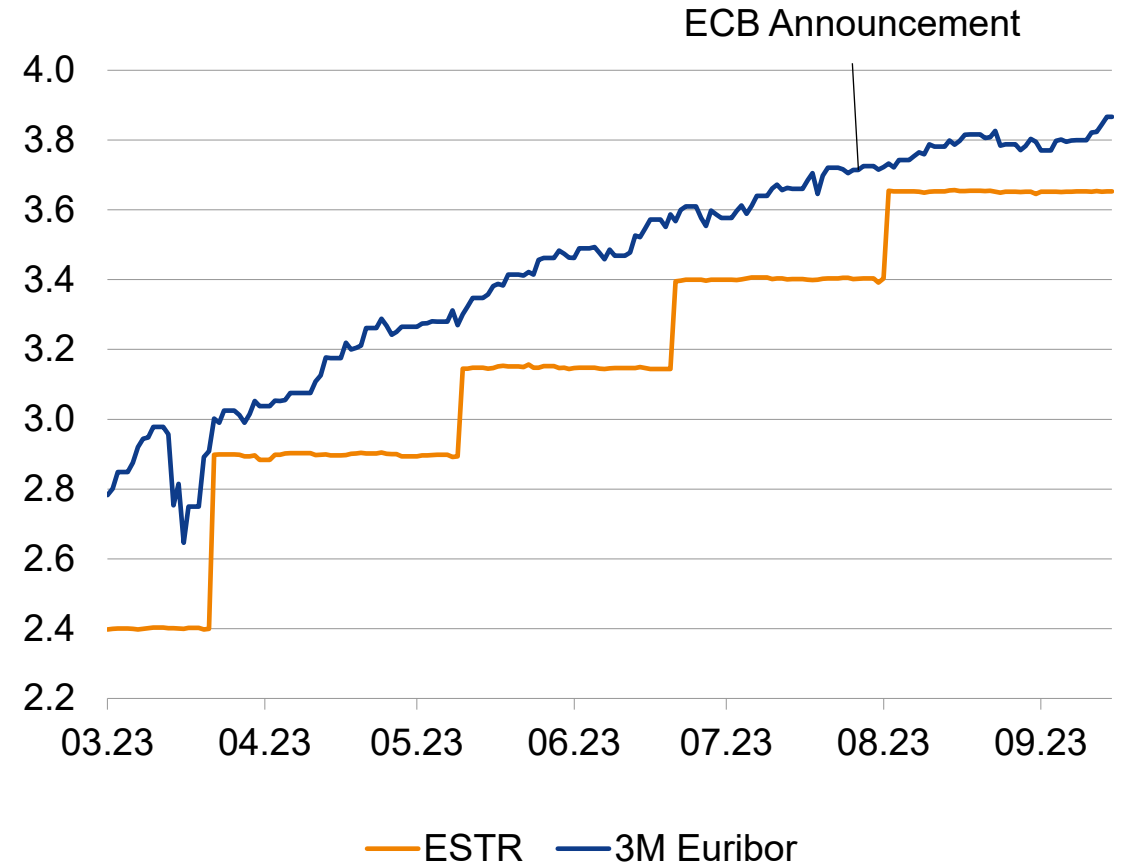


Bank shares suffer a setback

In Index points



In percent

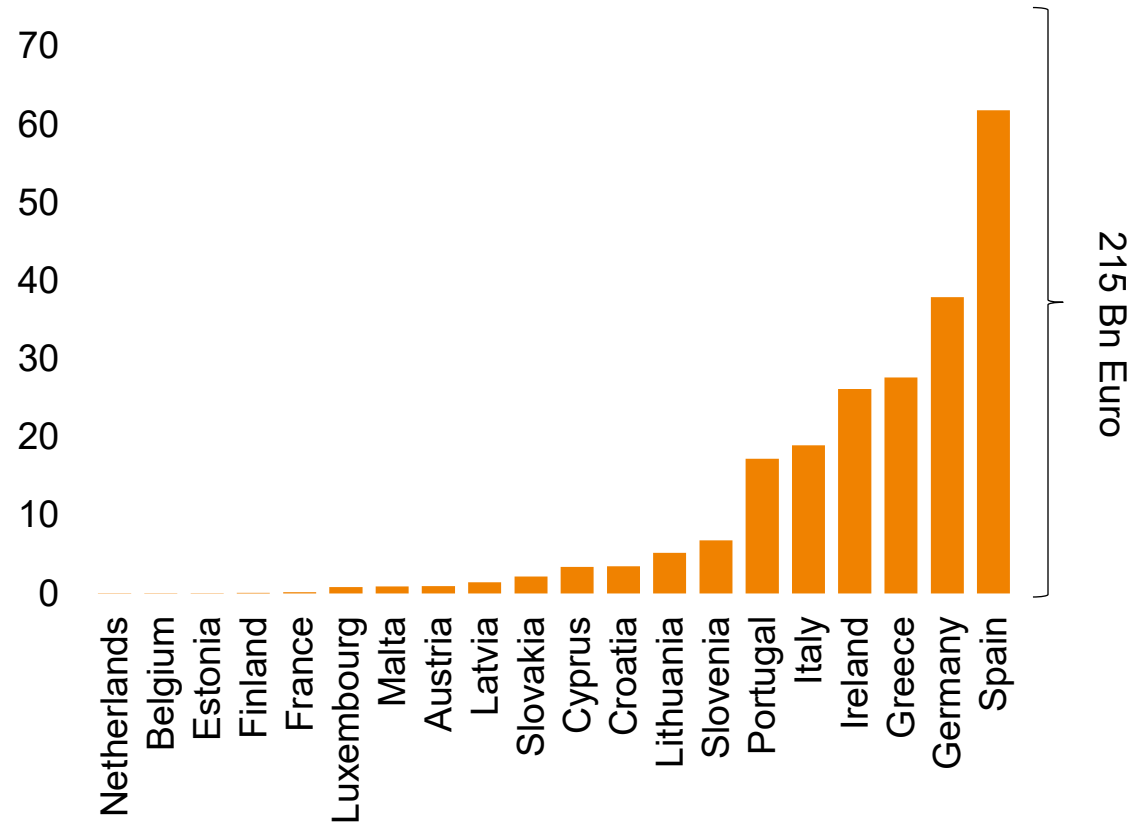


Various levers to reduce the ECB's interest rate bill



There is speculation about different options

Liabilities to other euro area residents / General Government / In Billions



- It would be conceivable that other central banks in the Eurozone follow the Bundesbank's example. The Spanish central bank has a large amount of liquidity parked by the government.
- However, it also seems conceivable that the ECB as such will gradually adjust the interest rate on government deposits downwards (current remuneration level at ESTR -20 bp)
- Other options to reduce the ECB interest bill and motivate markets to transmit liquidity:
 - Raising MRR minimum reserve requirement (currently 1% / est.165 bn Euro)
 - Introducing a reverse tiering system – setting a limit on the deposit facility to be remunerated at DFR – penalize everything above
 - Quantitative Tightening - Reduction in PEPP reinvestment
 - Active sales of government bonds from the bond portfolio
- or potentially regulatory changes in liquidity risk ratios as NSFR and LCR in order to further tighten grip on velocity and run-off scenarios

Source: ECB - Disaggregated financial statement of the Eurosystem (Reference Date 4. August); DZ BANK