

IMPACT OF ECB UNCONVENTIONAL MONETARY POLICY MEASURES

PRESENTATION TO THE ECB MONEY MARKET CONTACT GROUP

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Global Head of Short Term Treasury

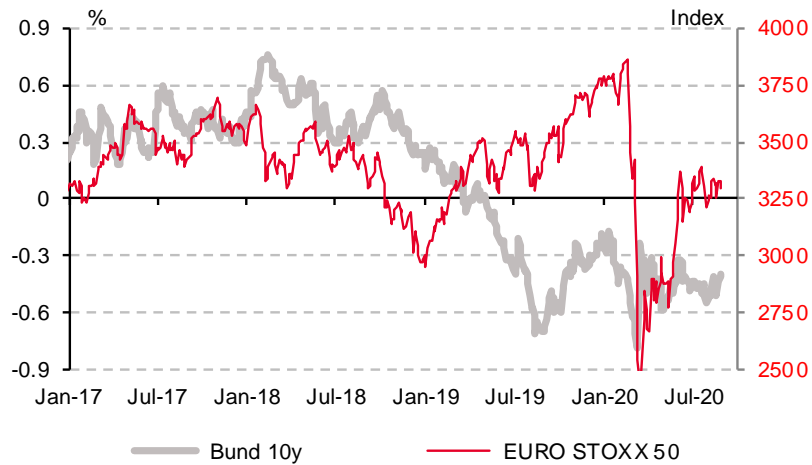
PRELIMINARY NOTE

THIS PRESENTATION IS NOT AN EXHAUSTIVE PANORAMA OF ALL IMPACTS OF UNCONVENTIONAL MONETARY POLICY LED BY THE ECB, BUT RATHER SOME TALKING POINTS ON SEVERAL ASPECTS WE THINK ARE REPRESENTATIVE OF THE EFFECTS OF ECB POLICY ON MARKETS

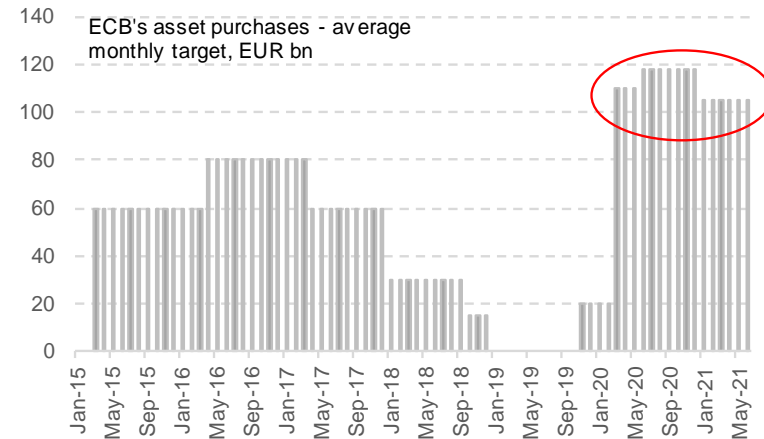
- 1. €STR**
- 2. EONIA SWAPS**
- 3. LIQUIDITY PREMIUM EUR VS USD**
- 4. TERM PREMIUM**
- 5. INFLATION BONDS VERSUS NOMINAL BONDS**
- 6. COUNTRY SPREADS**

COVID CRISIS – UNPRECEDENTED POLICY REACTION

Covid-19 shock



ECB's asset purchases at maximum power

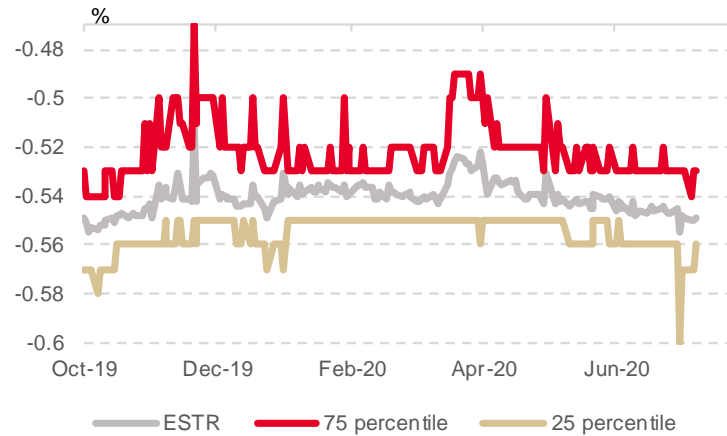


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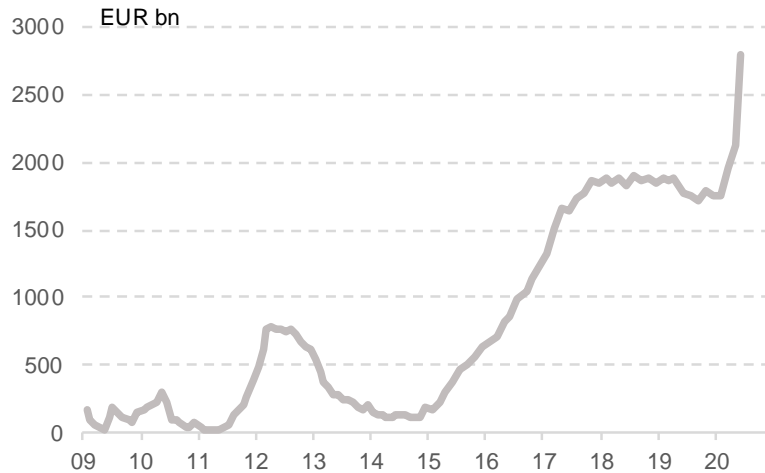
Source: SG Cross Asset Research/Rates, ECB

WITH EURO AREA EXCESS LIQUIDITY AT ITS HIGHEST, €STR COULD DRIFT LOWER

€STR decline: there is room for more decline

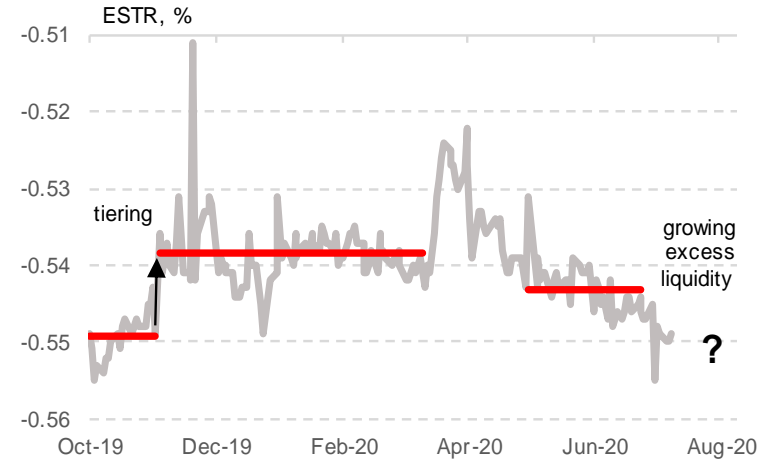


Euro area excess liquidity

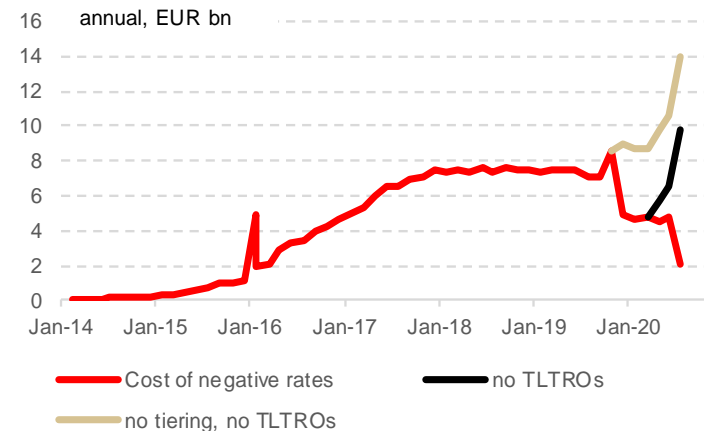


Source: SG Cross Asset Research/Rates.

€STR regimes – we are back to pre-tiering levels



Estimated annual aggregate cost of excess liquidity and negative rates for European banks



MARKET RESUMES PRICING RATE CUTS – BUT HOW MUCH IS DUE TO GREATER EXCESS LIQUIDITY ?

EONIA SWAP 1Y / 1Y FORWARD



Source: SG Cross Asset Research/Rates., ECB

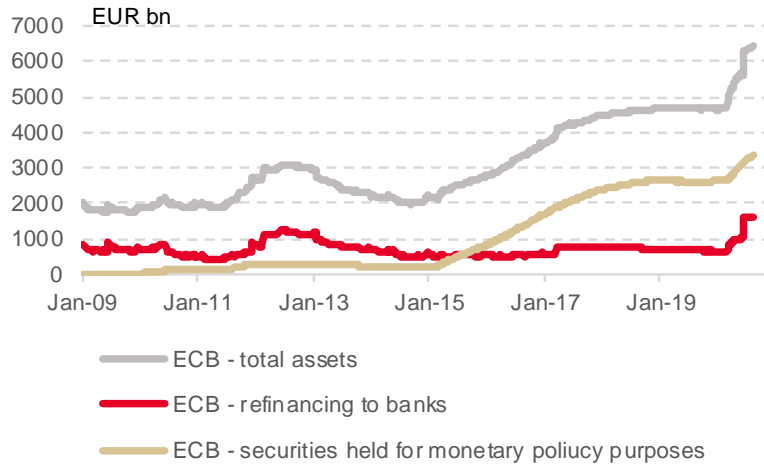
EUR/USD 3 M BASIS CLOSE TO PAR : NO MORE LIQUIDITY PREMIUM BETWEEN EUR AND USD IN THE SHORT TERM



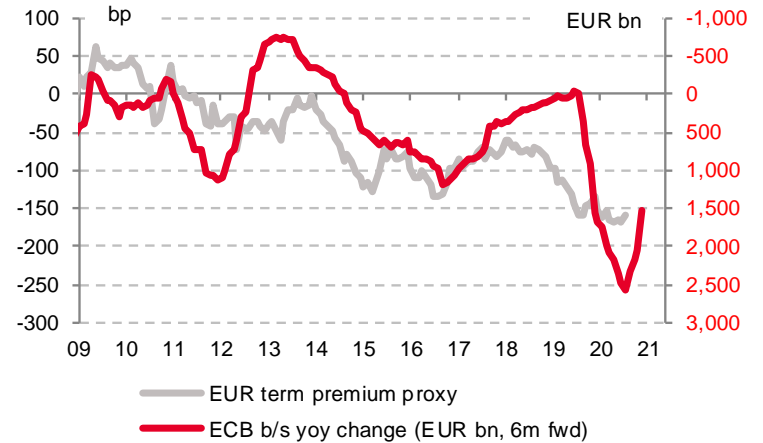
Source: SG Cross Asset Research/Rates., ECB

IMPACT OF GROWING ECB BALANCE-SHEET ON TERM PREMIUM IS PEAKING

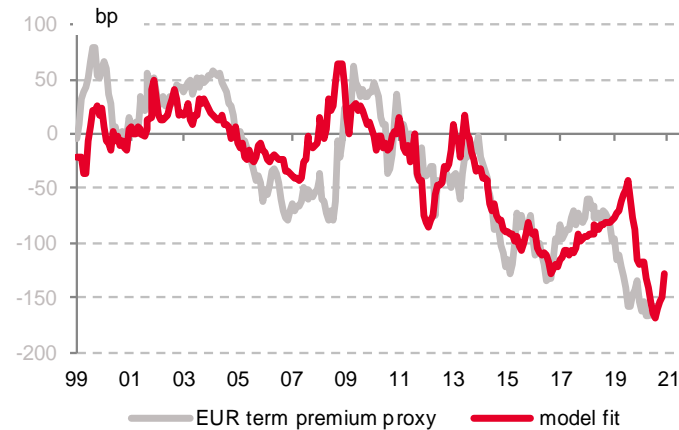
Growing ECB balance sheet



The impact of growing ECB balance sheet on EUR term premium compression peaked this summer



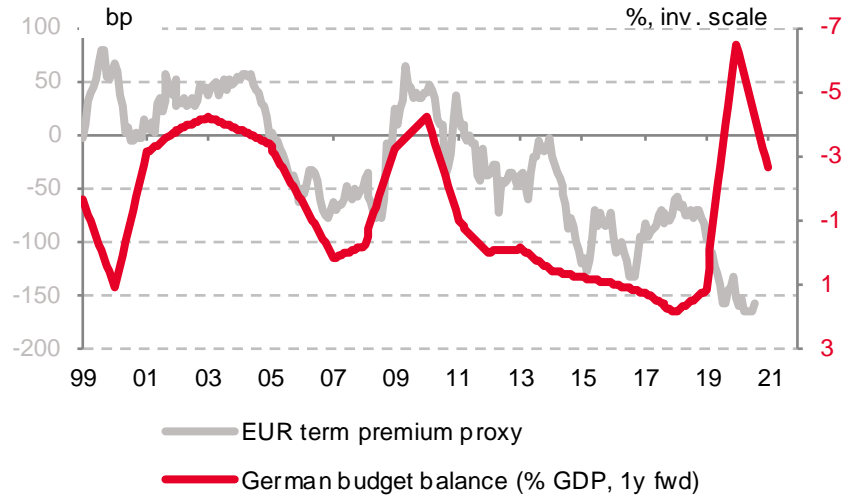
...BUT expectations of another PEPP extension delay EUR term premium normalisation



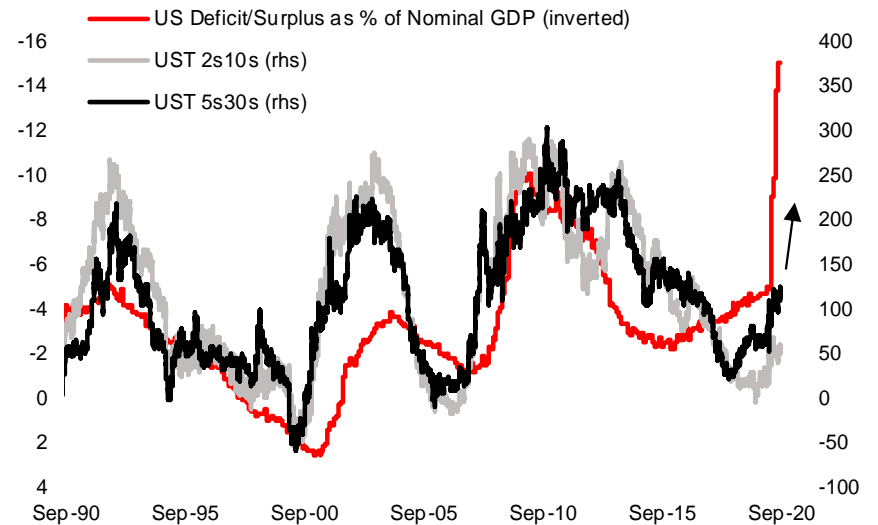
Source: SG Cross Asset Research/Rates. EUR term premium proxy is the residual of 2-10y regression on 2y rate estimated on data between 1999 and 2013.



WITH MASSIVE ECB EASING, FLATTER CURVES THAT ONE SHOULD EXPECT IN A WORLD OF RISING DEFICIT



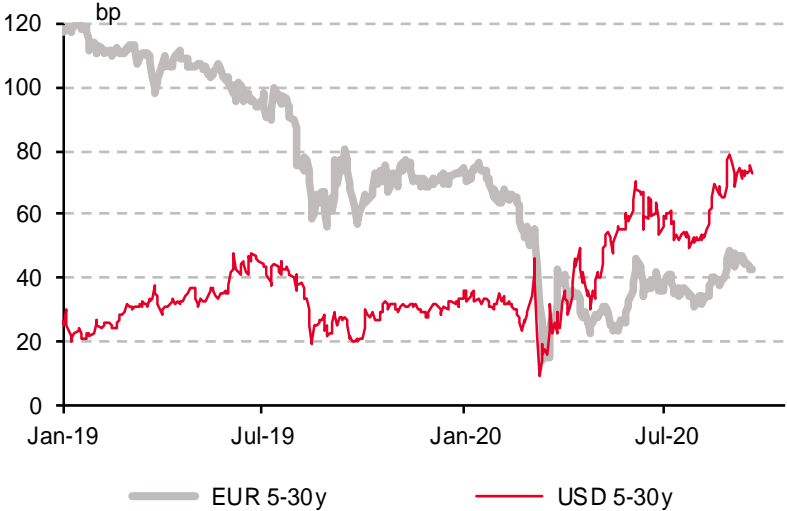
Higher deficits tend to be accompanied by steeper curves



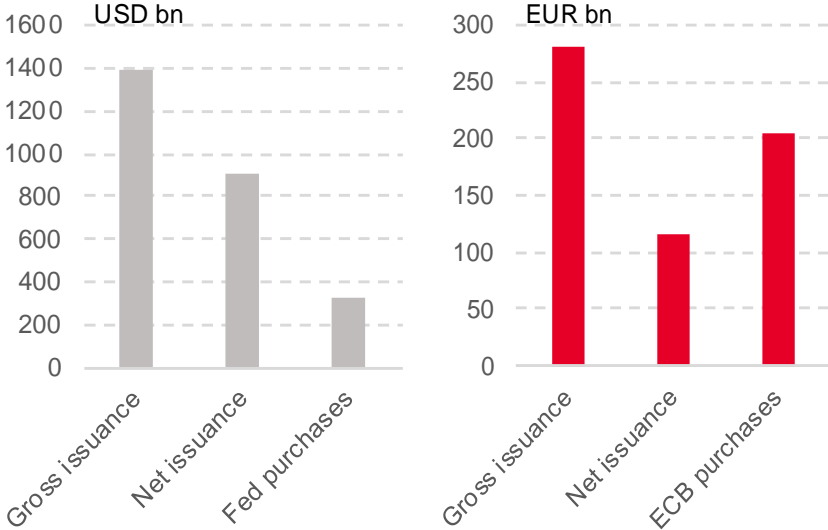
Source: SG Cross Asset Research/Rates. EUR term premium proxy is the residual of 2-10y regression on 2y rate estimated on data between 1999 and 2019

ECB IMPACT ON TERM PREMIUM IS STRONGER THAN THE FED'S ONE

A firmer steepening bias in USD than in EUR



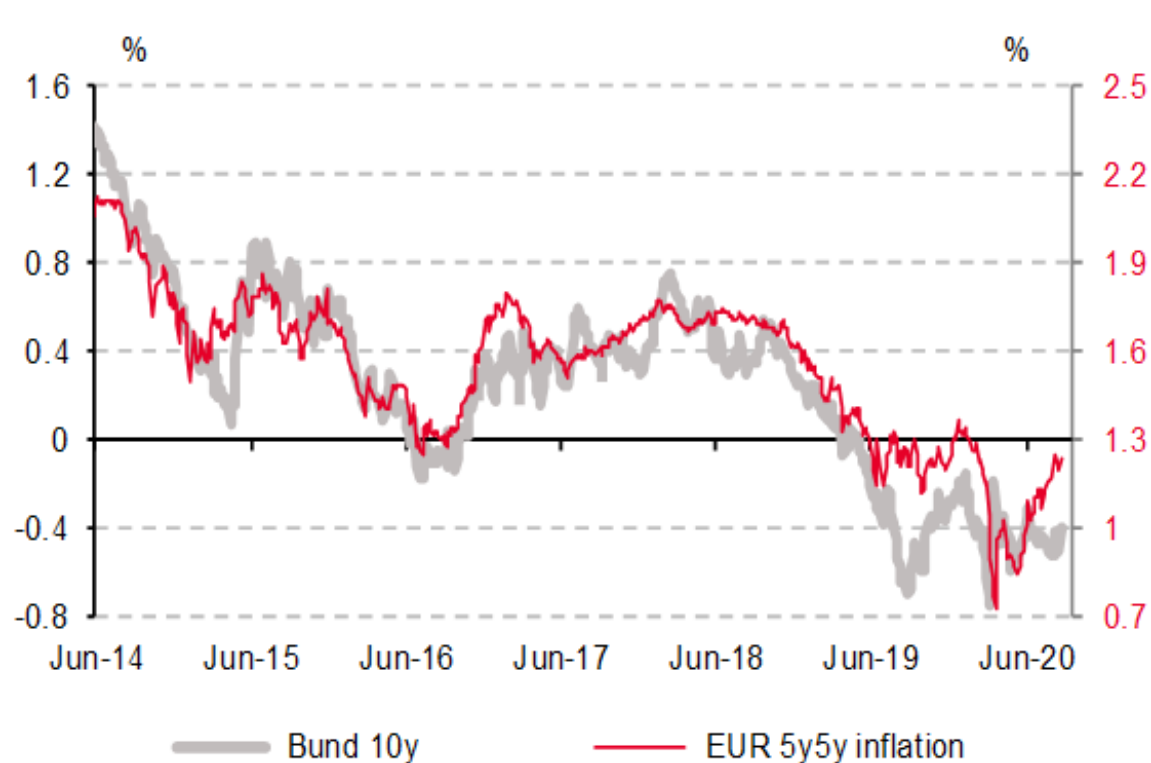
Fed is buying roughly one-third of the net supply of US Treasuries, while the ECB purchases almost twice more



Source: SG Cross Asset Research/Rates. The graph shows expected issuance and CB purchases between September and December 2020. In EUR, we focus only on Germany, France, Italy and Spain.

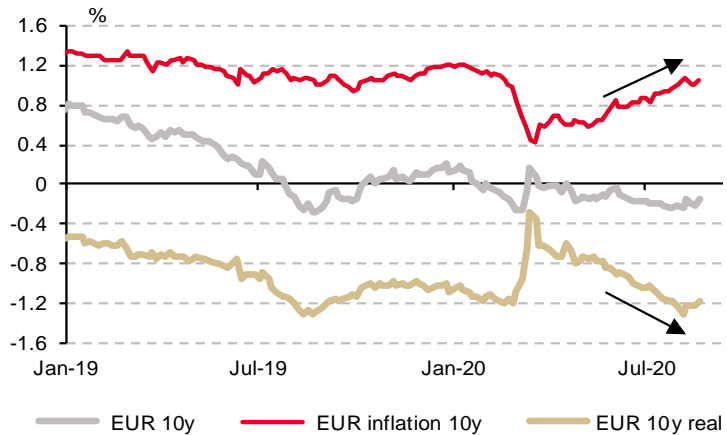
DIVERGENCE BETWEEN INFLATION AND NOMINAL BONDS

WE HAVE SEEN A NORMALIZATION IN INFLATION BREAKEVENS TO PRE-COVID LEVELS WHILE NOMINAL RATES LAG BEHIND

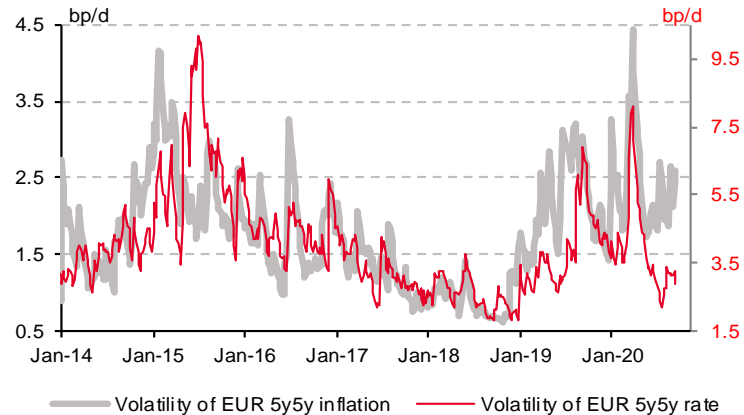


LOW VOLATILITY IN NOMINAL RATES COMPARED TO INFLATION BREAKEVENS

Nominal rates not following the repricing up of inflation, resulting in deeply negative real rates



High inflation breakeven volatility compared to nominal rates volatility



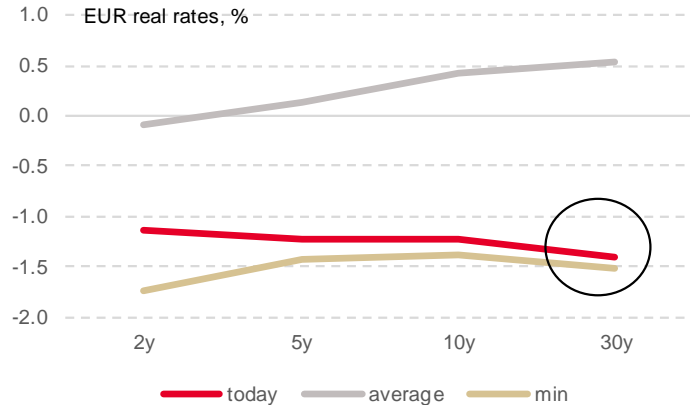
Source: SG Cross Asset Research/Rates

- The modest repricing higher of inflation has been insufficient to drive nominal rates up – given dovish central ECB and uncertain economic outlook
- Central bank money injections lead to real asset price inflation (higher equities, real estate, gold and lower real rates) without much impact on the economy....
- **A durable rise in nominal rates would require real rates to redirect up → For this, the economic outlook needs to improve. Technical factors (higher issuance) can be another temporary driver. Yet, dovish ECB limits the potential.**

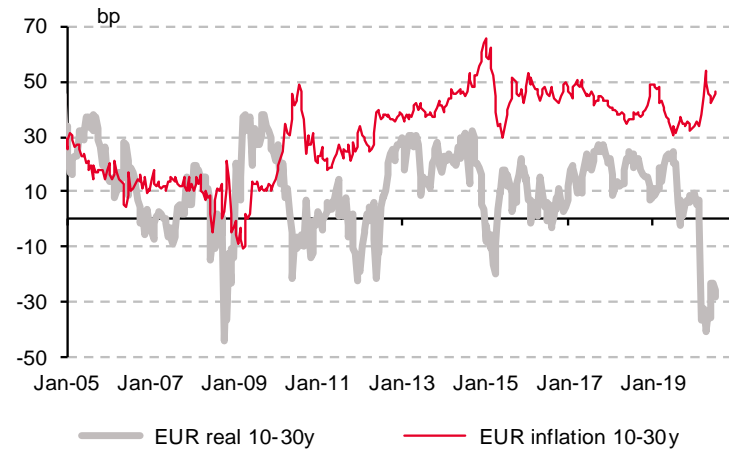
- Fed's flexible average inflation targeting reduces the sensitivity of monetary policy expectations relative to inflation expectations.
- This should support the case for **higher inflation volatility relative to nominal rates volatility** also in EUR.

INVERTED EUR 10-30Y REAL SLOPE – THIS IS TYPICALLY TEMPORARY

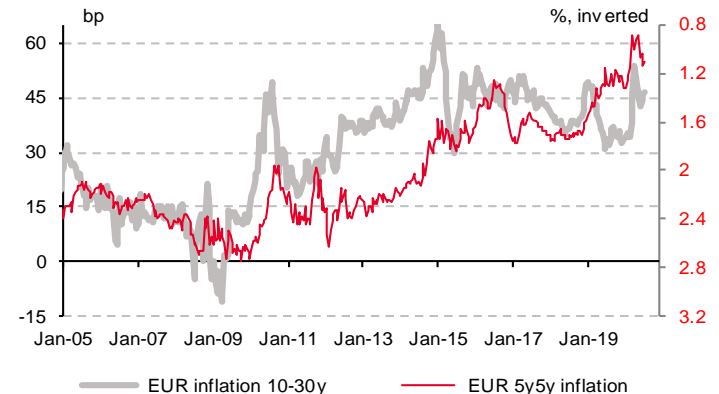
Term structure of EUR real rates: inverted slope and 30y at lows



Inverted EUR 10-30y real slope is a by-product of compressed nominal term premium and upward sloping inflation curve



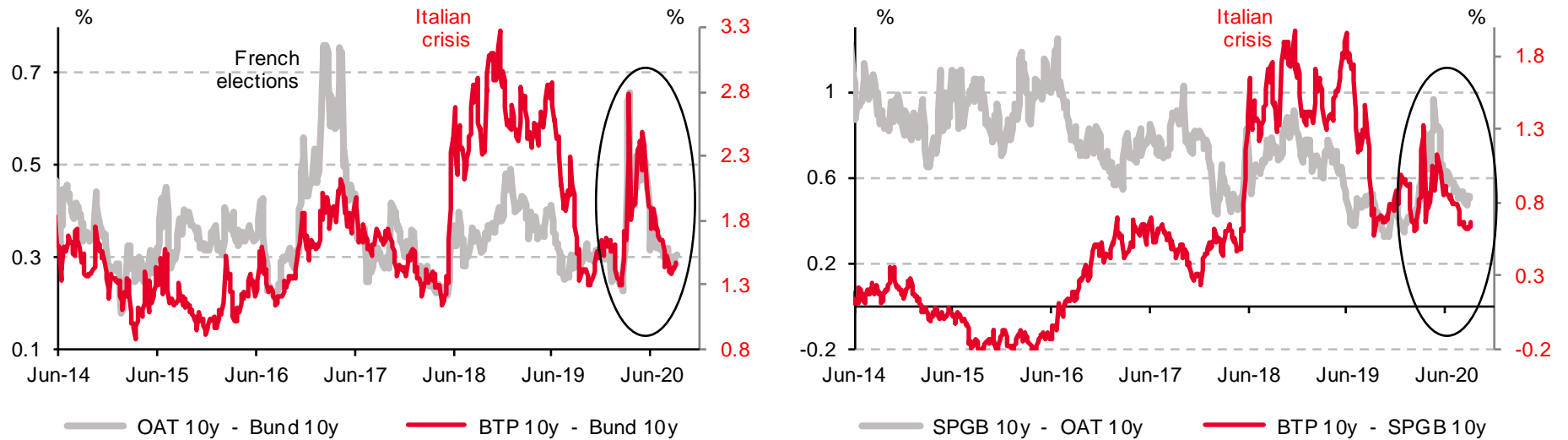
Step inflation slope is consistent with low inflation pricing



Source: SG Cross Asset Research/Rates.

A DOVISH ECB LEADS TO NARROWER SPREADS

Country spreads are correlated again: common factor now is hunt for yield and carry



Source: SG Cross Asset Research

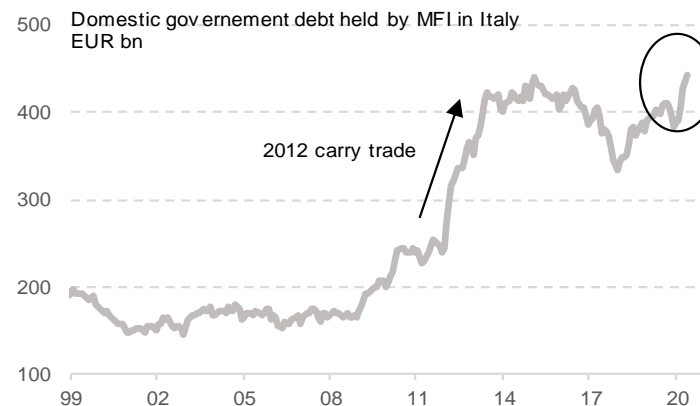
CARRY TRADE SINCE MARCH

Purchases of debt securities issued by domestic General Government reported by banks (in €bn)

	Mar-May	Mar	April	May
France	56.8	2.3	32.0	22.5
Italy	56.4	19.7	25.7	11.0
Spain	33.3	17.7	7.2	8.3
Germany	17.0	8.3	3.9	4.9
Belgium	3.6	2.8	0.9	-0.2
Portugal	3.2	0.7	1.5	1.1
Greece	2.7	1.4	0.7	0.5
Netherlands	1.8	-0.1	1.7	0.2
Ireland	1.7	0.8	-0.5	1.4
Austria	1.7	0.1	1.6	0.0
Finland	0.4	0.7	0.0	-0.3

Source: SG Cross Asset Research/Rates., ECB

Italian banks holdings of BTPs at new highs



French banks holdings of OATs jump to highs not seen since late 90s

