



Full slide pack



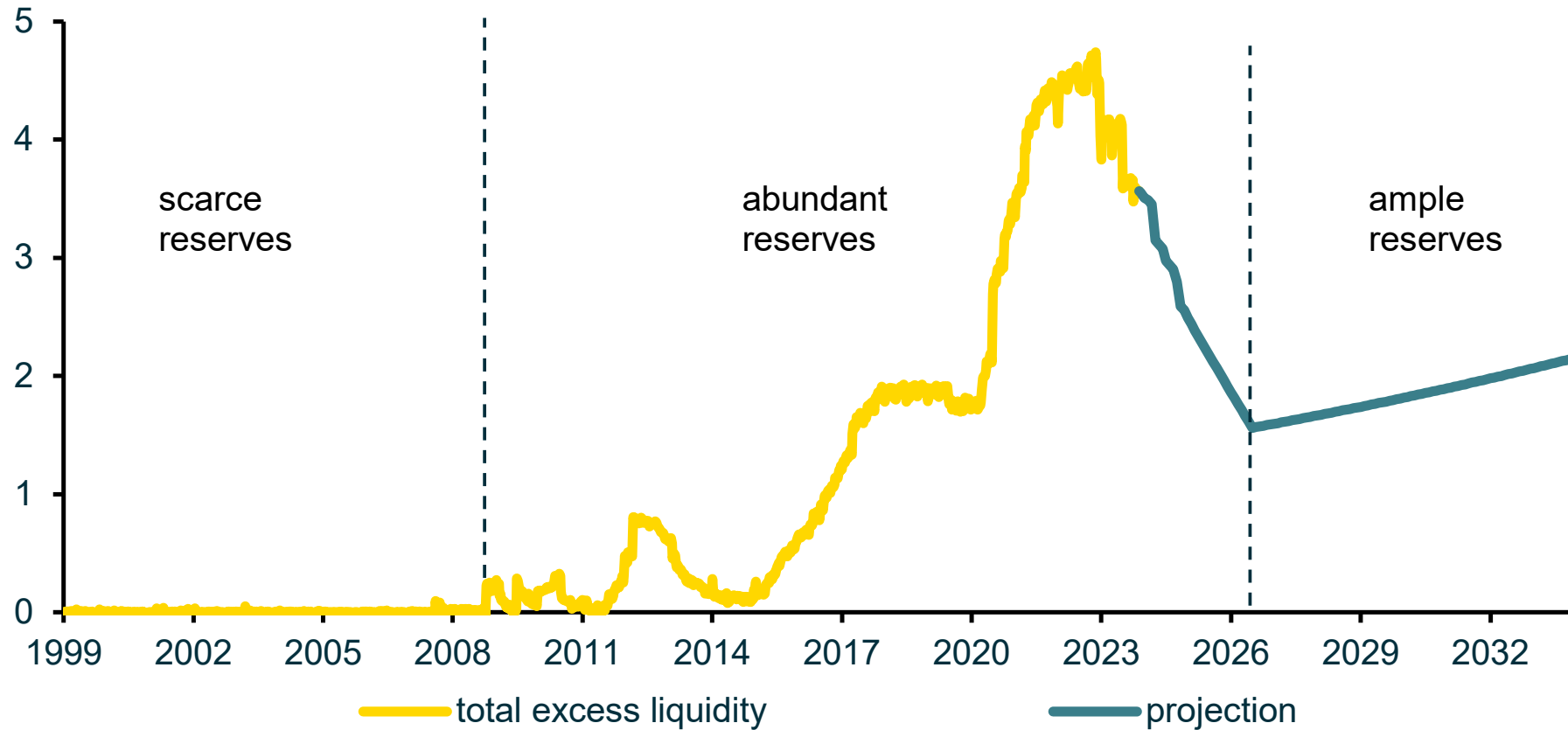
ECB 3.0: Constructing a new floor!

Christoph Rieger, 27 June 2024



ECB 3.0 – from scarce over abundant to ample

ECB excess liquidity, incl. projection, in € trn



Source: Bloomberg, Commerzbank Research



Key questions:

- **What will change under the new operational framework?**
- **Where is FREL?**
- **When will the ECB balance sheet grow “durably” again?**
- **How attractive is ‘depo+15’?**
- **How will spreads react?**
- ... how far will the ECB cut and where are OATs heading?



Operational Framework





Operational Framework Review: What is it all about?



Key goals

- Ensure consistent implementation of monetary policy stance when excess liquidity falls to critical levels
- Keep control of €STR during transition phase and in new steady state
- Stimulate money market activity / interbank trading



Key questions

- System: Floor or corridor?
- Balance sheet size: Lean or large?
- Liquidity provision: Open market operations (OMOs) or structural bond portfolio?
- Parameter details:
 - OMOs: Maturities, pricing, collateral
 - Bond portfolio: Asset classes, maturities, capital key, legacy portfolios separate?



Operational Framework Review: Results

Approach

- The framework can be characterised as a **demand-led floor system with some structural supply-side elements**.
- ECB is distinguishing less between lending operations and bond purchases but rather draws a line between short-term and structural operations.
- Unless the ECB chooses a larger weight and more generous design for its structural operations, the system is closer to the ideas of Mrs. Schnabel than the setup that had been favoured by Mr. Lane's staff.

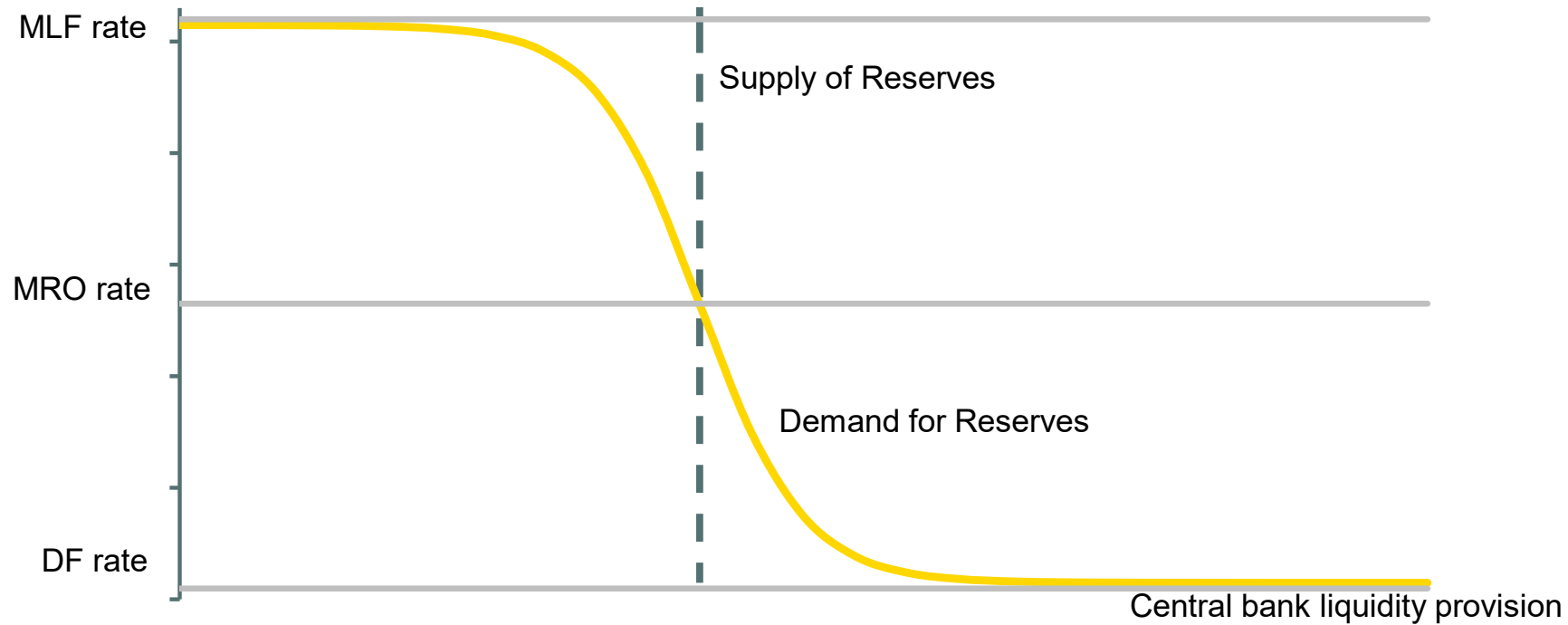
Instruments

- **1w MROs and 3m LTROs** with fixed rate full allotment against broad collateral at depo+15bp. Allotment rate will therefore be reduced by 35bp from 18 September.
- **Structural longer-term refinancing operations** and a **structural bond portfolio** will be introduced "at a later stage, once the Eurosystem balance sheet begins to grow durably again, taking into account legacy bond holdings."
- **Minimum Required Reserves (MRR)** unchanged at 1% of relevant liabilities.



Stylised supply and demand of reserves

Interest rates in relation to supply and demand of reserves



Source: Commerzbank Research



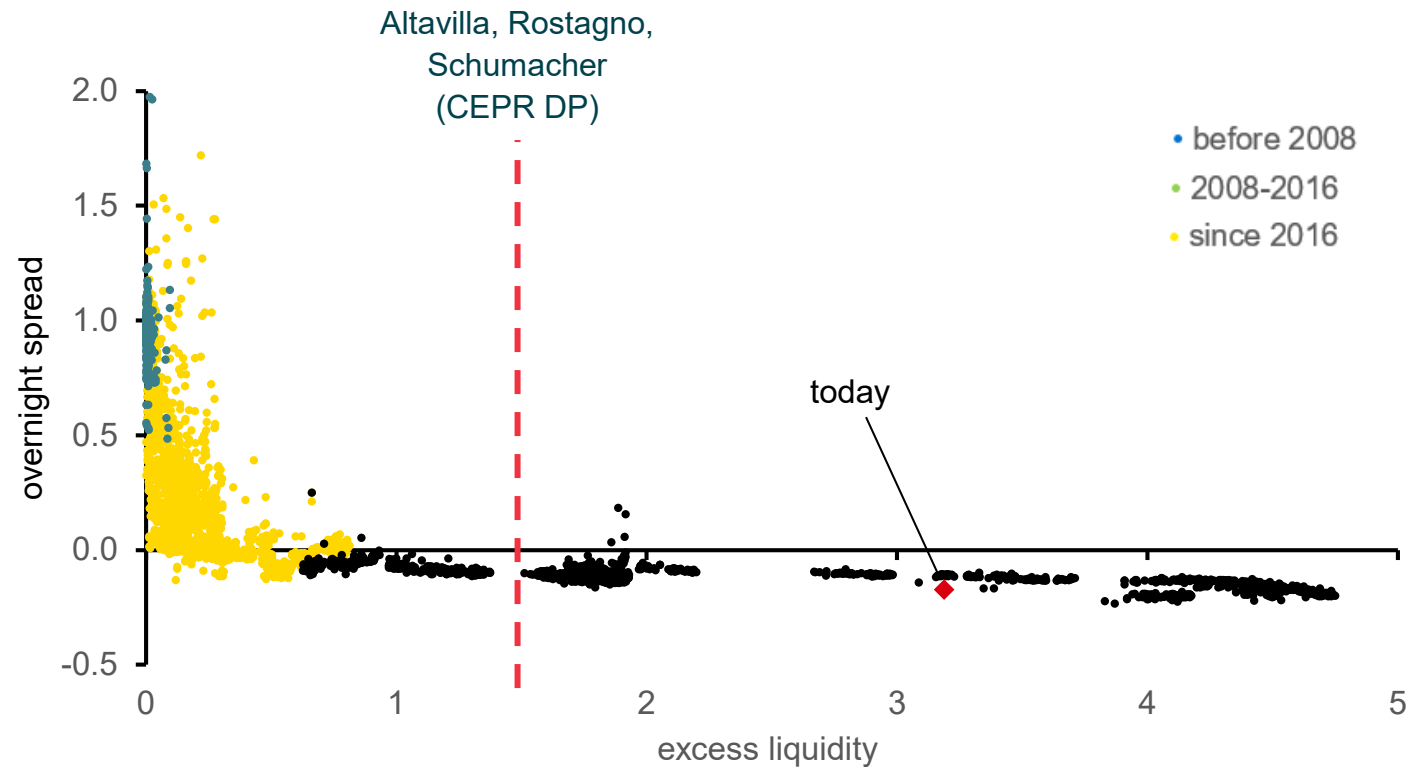
Where is FREL?

What is FREL?

one acronym - two usages

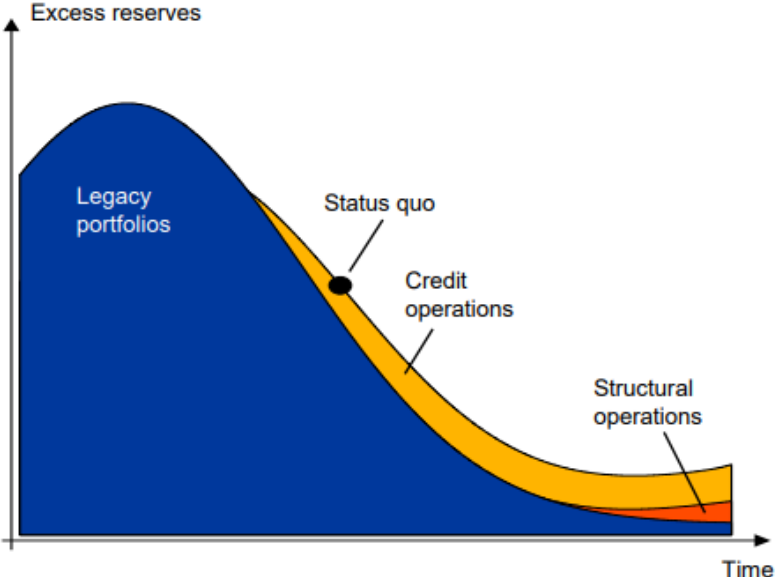
- Floor Required Excess Liquidity
- Friedman Rule consistent Excess Liquidity

ECB excess liquidity, in € trn, vs. overnight - depo spread in % (using EONIA -8.5bp before 2019, €STR thereafter)

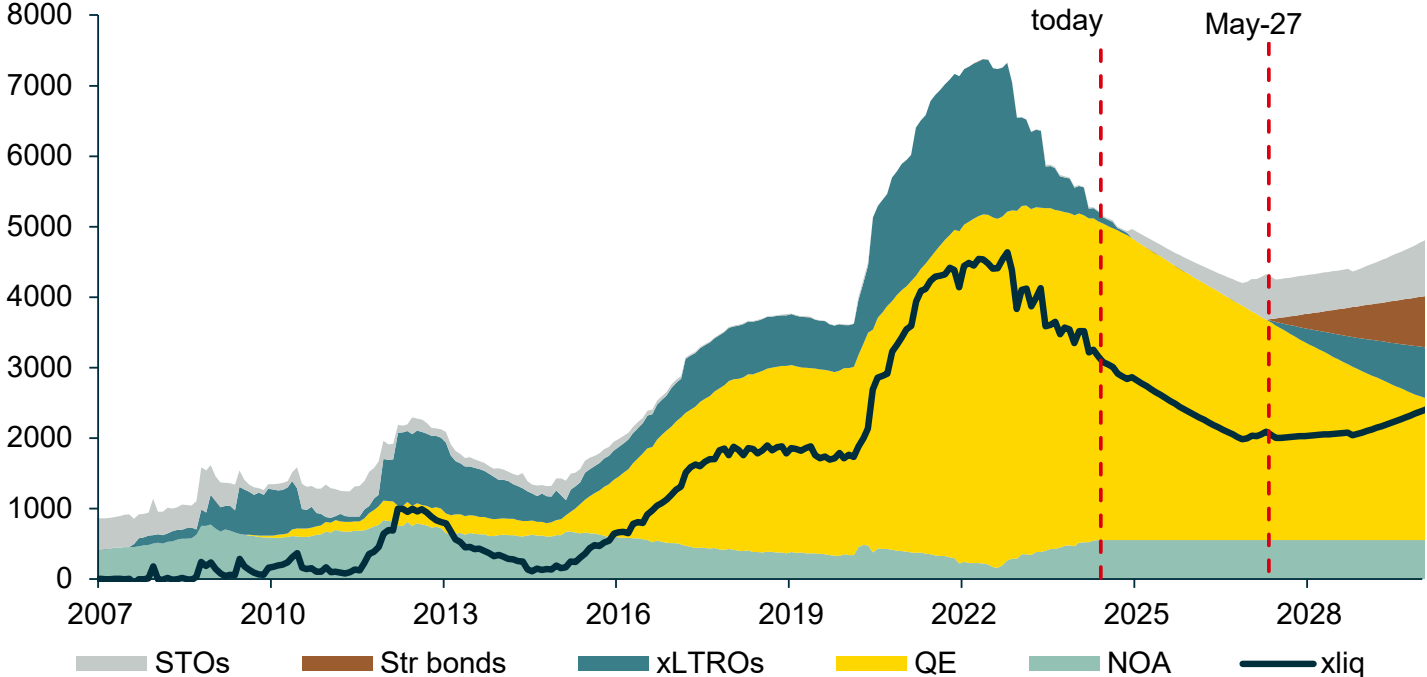


Source: ECB, CEPR, Bloomberg, Commerzbank Research

When (and how) will the ECB balance sheet grow “durably” again?



Reserve supplying Eurosystem assets, including projections (assumptions, see [AotC 21Mar](#)), in € bn. "Str. bonds" is structural bond portfolio, NOA is net other assets, STO is short-term operations (MRO and 3M LTRO)

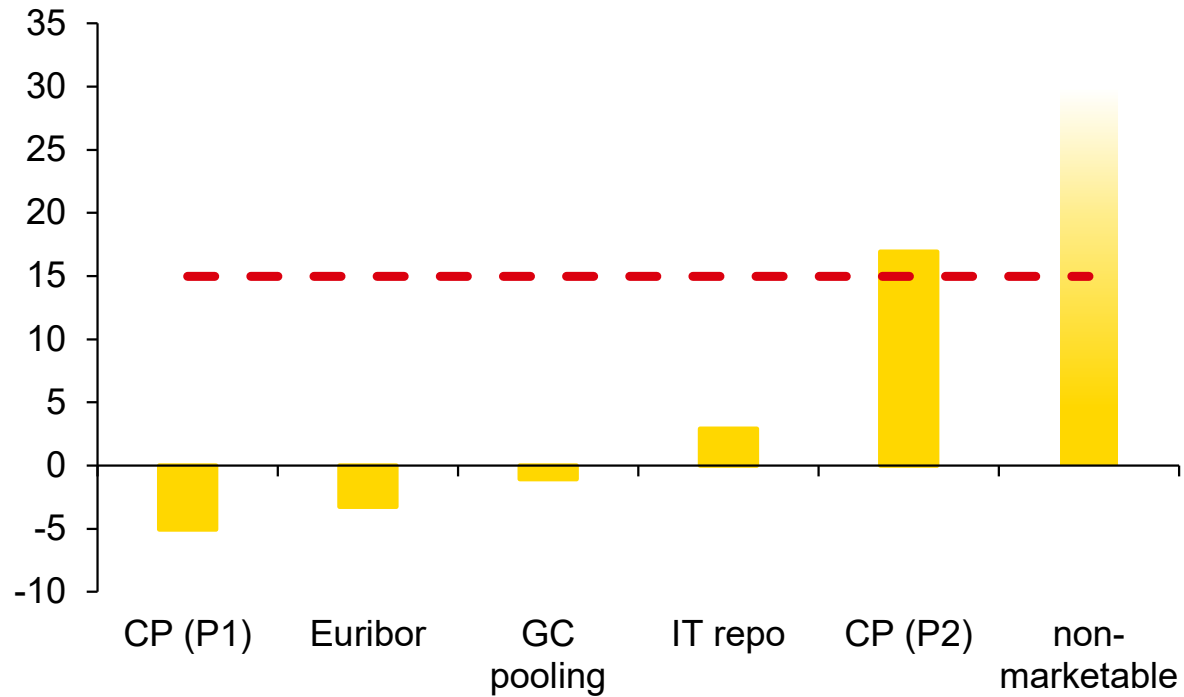


Source: ECB, Bloomberg, Commerzbank Research

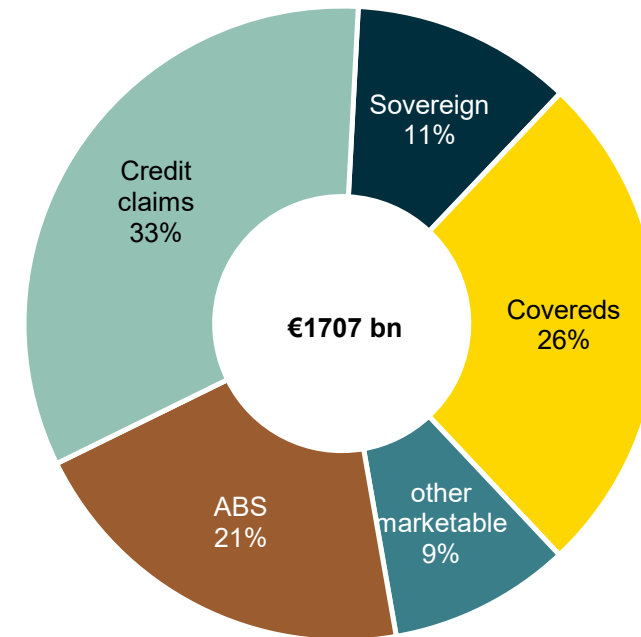


How attractive is 'depo+15'?

Selected 3M spreads over ECB depo, in %



Eurosystem use of collateral, in € bn (Q1 2024)



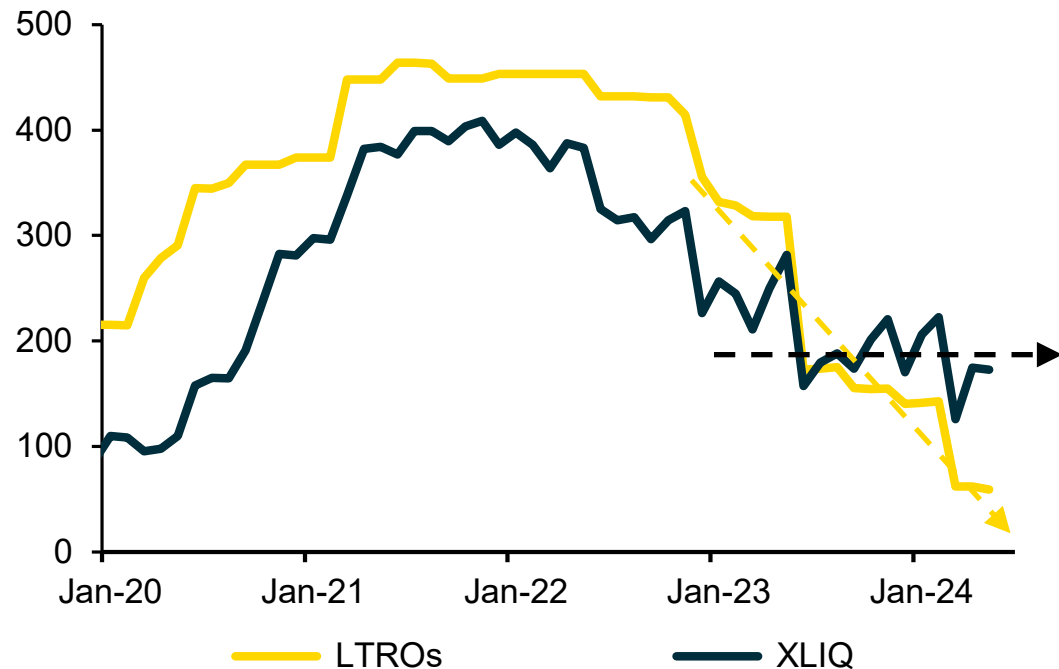
Source: Bloomberg, Commerzbank Research



How will spreads react to 'neutral'?

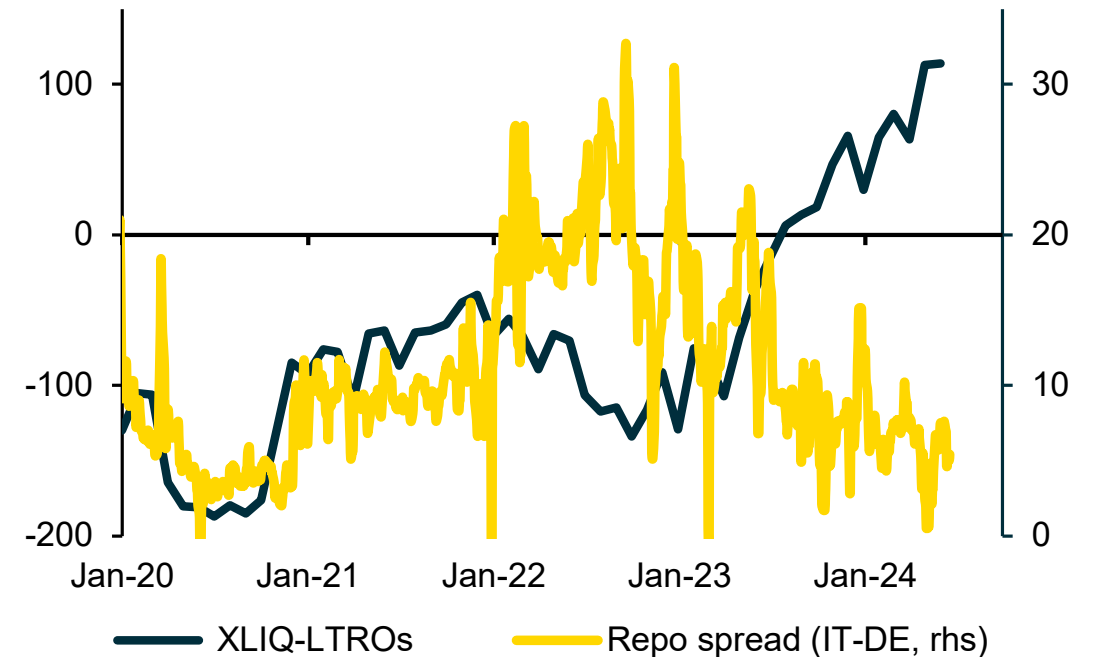
Italian banks managed the TLTRO journey well...

Italian banks' outstanding LTROs and excess liquidity, in € bn



... without upward pressure on repo rates!

Italian banks' excess liquidity minus outstanding LTROs, in € bn, and Italian-German repo spread, in bp (daily average adjusted for outliers)

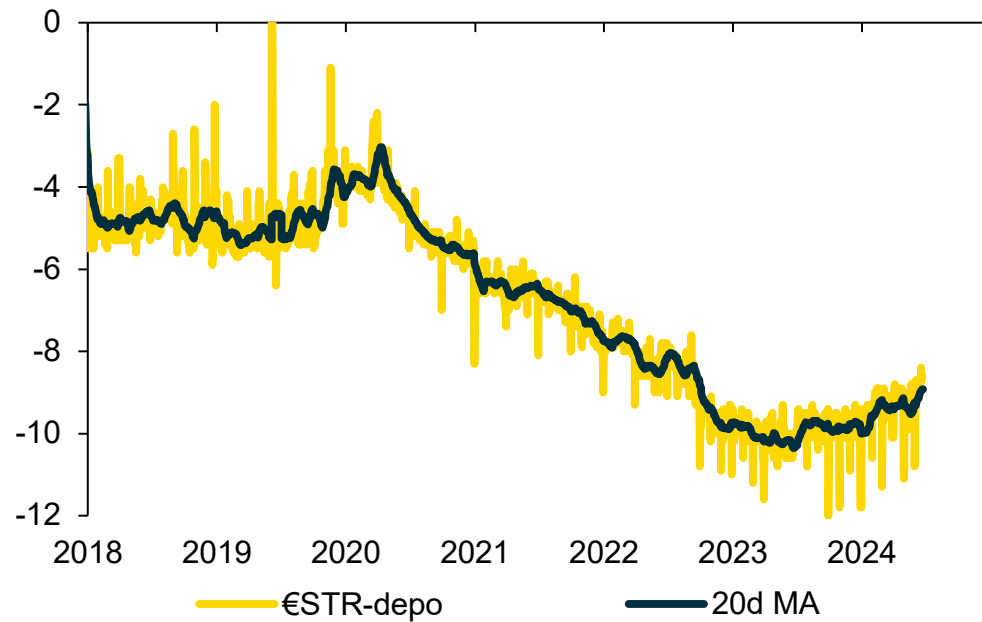


Source: Bloomberg, Commerzbank Research

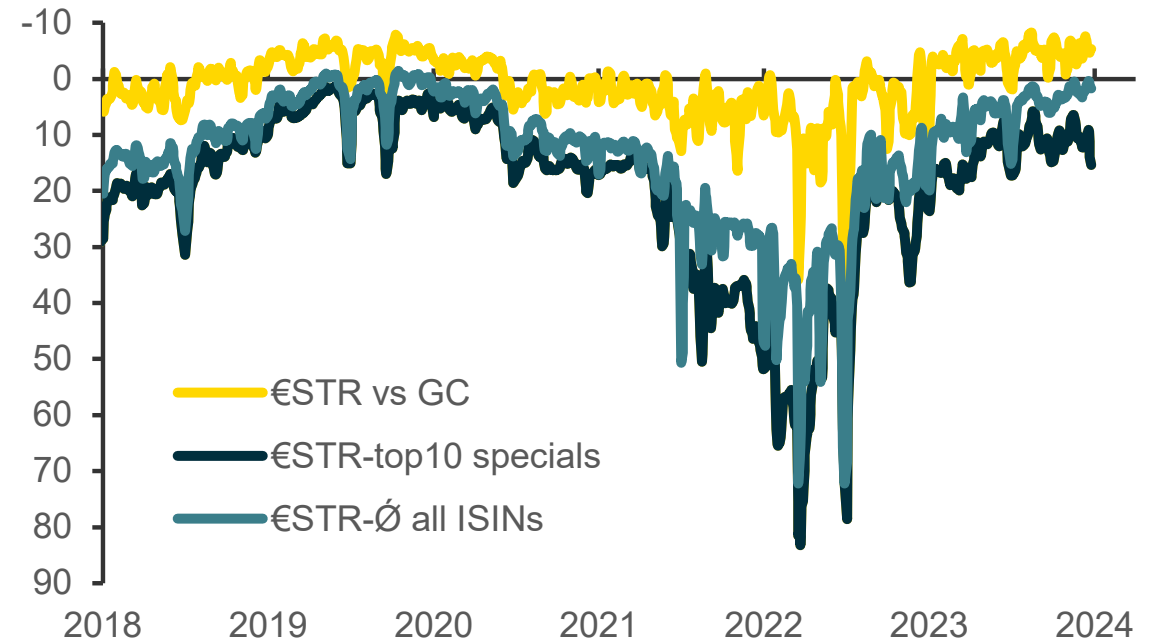


How will spreads react to 'neutral'?

€STR inching higher in homeopathic doses
€STR/EONIA spread vs ECB depo rate, in bp



Collateral abundance prevailing in repos
German s/n repos vs. €STR, in bp



Source: Bloomberg, Commerzbank Research



Discussion

- **How should the ECB design its structural operations?**
- **Where do you see FREL?**
- **Will unsecured rates ever converge to repos again?**
- **Is 'depo+15' attractive?**
- **Is Euribor still fit for purpose?**
- ... what's up with Inflation, how far will the ECB cut rates, where are OAT spreads heading?



Inflation, ECB, France



Inflation momentum: Worse than Q4, but not as bad as Q1



Annualised monthly increase in seasonally adjusted HICP indices, in %

	core			components						
	headline	ex energy	ex energy / food	services	goods	IG	NEIG	food	pro-cessed food	unpro-cessed food
Oct-23	0.87	2.41	2.29	4.13	-1.58	-4.07	-0.53	2.96	2.71	3.62
Nov-23	-2.20	0.30	-0.61	-0.50	-3.41	-7.29	-0.63	3.50	1.52	10.82
Dec-23	0.29	2.40	2.91	3.59	-2.05	-3.45	2.03	0.44	0.45	0.43
Jan-24	5.04	3.93	3.54	5.15	5.21	5.20	1.49	5.32	5.84	3.40
Feb-24	4.72	3.30	4.38	6.08	3.53	5.79	1.27	-0.44	2.96	-11.51
Mar-24	2.23	2.79	3.62	6.16	-0.93	-1.35	-0.73	-0.18	1.06	-4.33
Apr-24	2.13	2.08	2.26	2.82	0.75	0.49	-0.53	1.15	1.24	0.44
May-24	1.64	3.38	4.34	6.53	-2.22	-3.62	0.53	0.53	0.80	-0.26

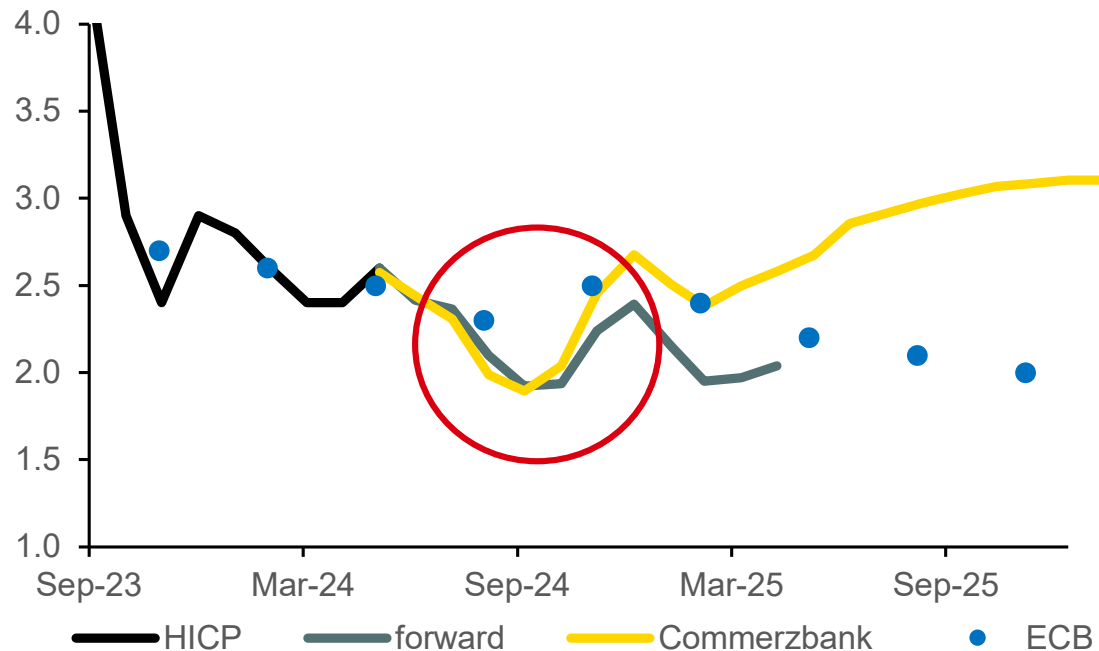
Source: ECB, Commerzbank Research



Inflation trough in September!

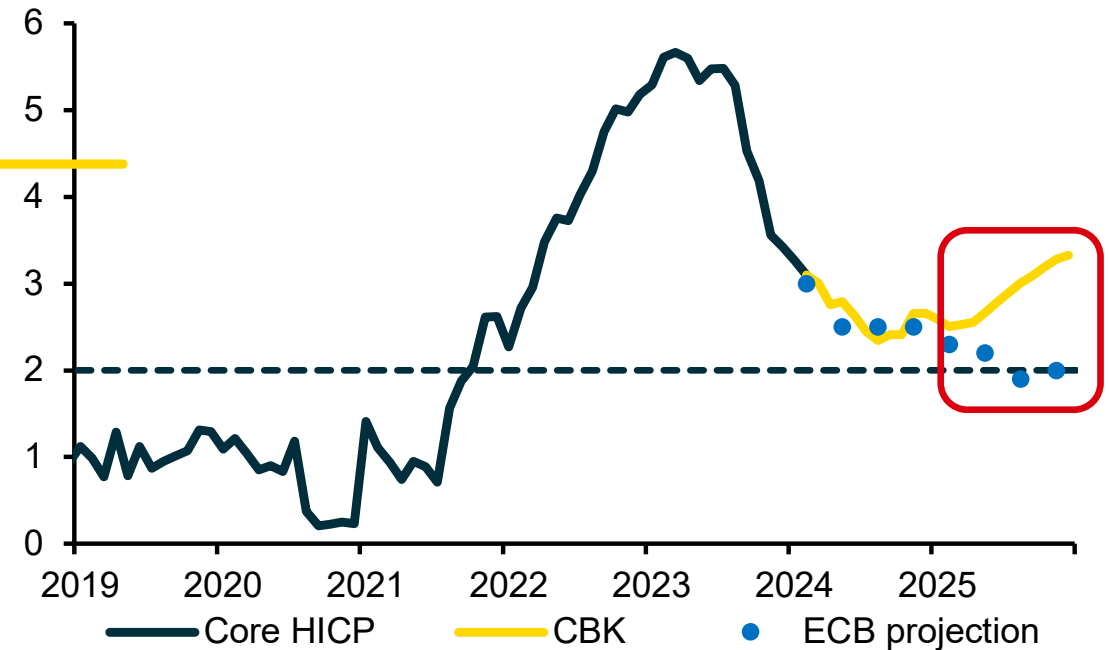
Sep € HICP forwards below 2%!

€ headline HICP, incl. Commerzbank forecast, forwards and ECB projections, y/y in %



Convergence with 2% or 3%?

€ core HICP, incl. Commerzbank forecast ECB projections, y/y in %

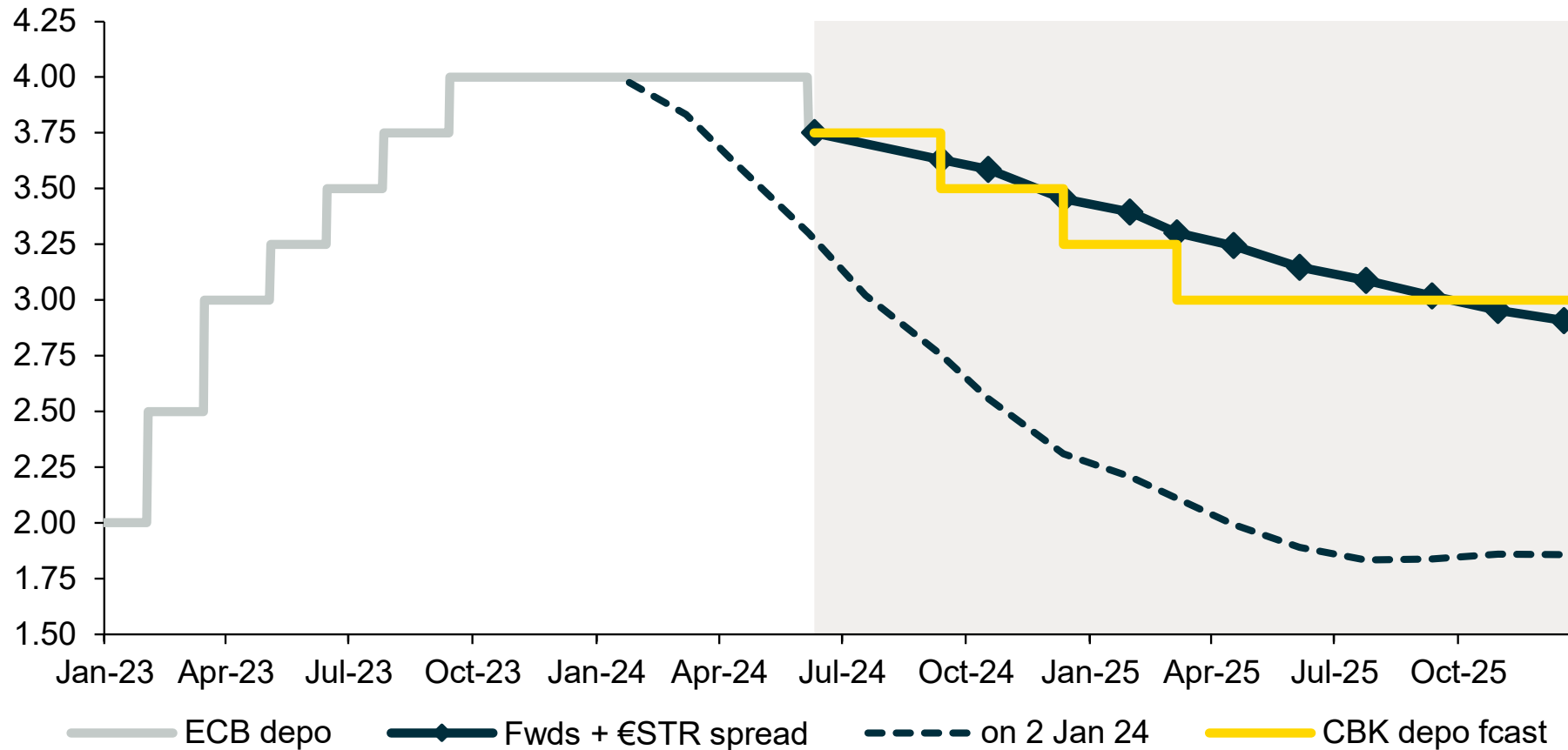


Source: Bloomberg, Commerzbank Research



ECB: To dial, or not to dial...

ECB depo rate and Commerzbank forecast, 1M €STR and forwards, in %



"I cannot confirm that it is the dialling-back process that is underway... but there's a strong likelihood".

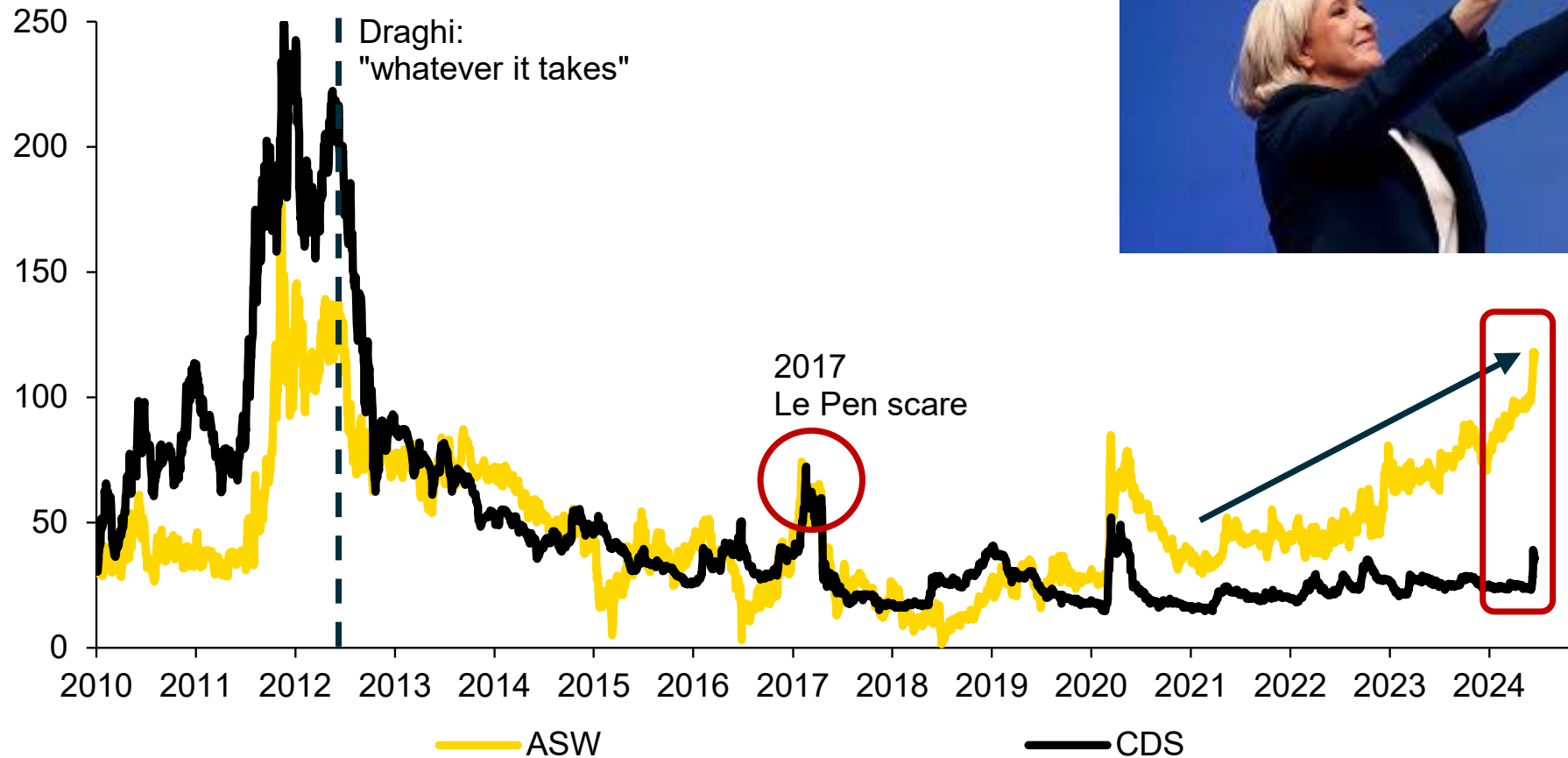
Christine Lagarde, 5 June press conference

Source: Bloomberg, Commerzbank Research



France: These tensions are different!

Supply pressure more relevant for spreads than credit anxiety
30y OAT asset swap spread and 5y CDS, in bp

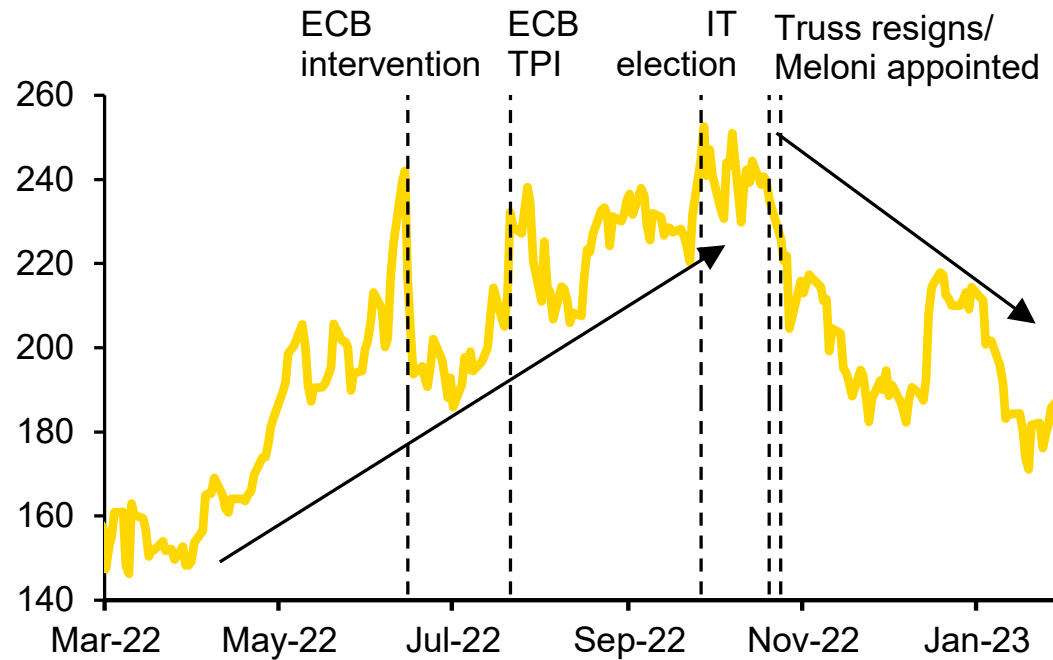


Source: Bloomberg, Commerzbank Research

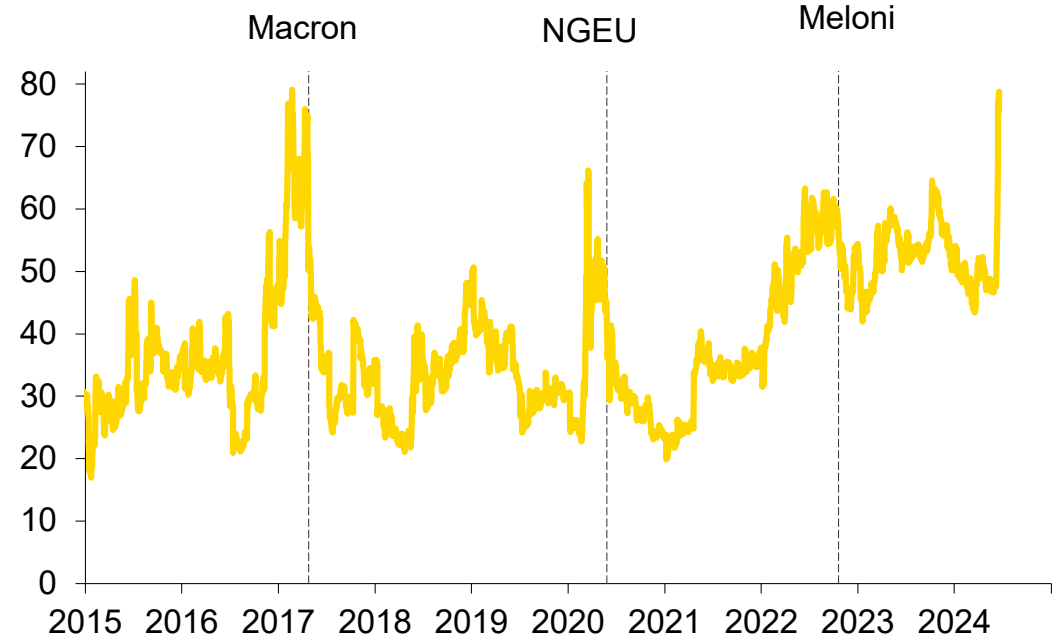


“Melonisation” hopes!

Buying opportunity on election day – thank you, Liz!
10y BTP-Bund spread around the Italian election in 2022



Meloni-hopes arrest OAT widening at 6y high
10y OAT-Bund spread, in bp



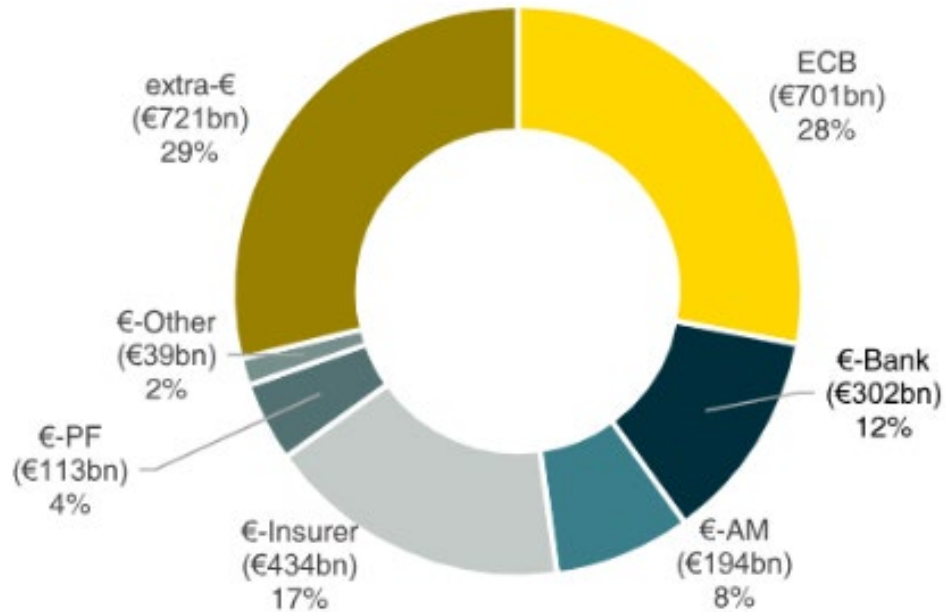
Source: Bloomberg, Commerzbank Research



“Melonisation” hopes!

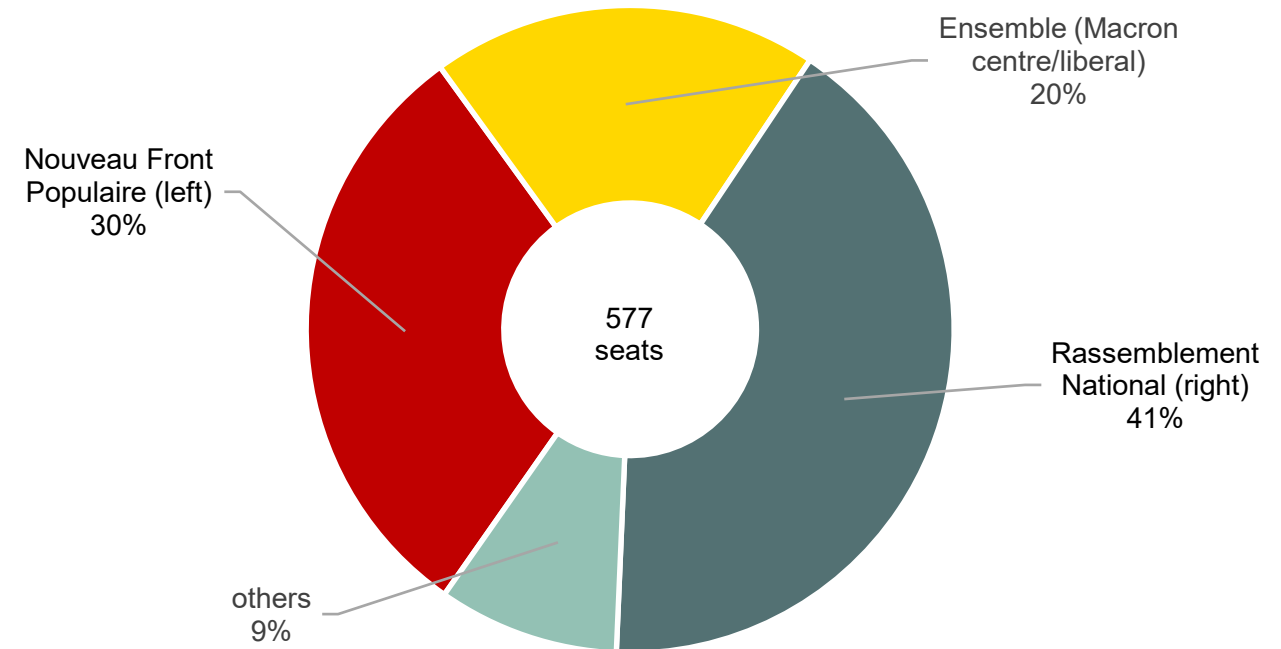
Overseas investors and domestic banks no longer ‘short’ OATs

Investor split of OATs with 1y+ residual maturity, as of Q1-2024, based on notional values



Unclear majorities a likely outcome of the French election

National Assembly seat projections, mid-point averages from three polls conducted since new election was called



Source: Bloomberg, Commerzbank Research



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Overweight (OW) We expect outperformance versus the benchmark in spread and/or total return terms

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Underweight (UW) We expect underperformance versus the benchmark in spread and/or total return terms

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	All covered instruments	The proportion of issuers in each of these categories for which Commerzbank provides investment banking services
Overweight	33%	33%
Marketweight	33%	67%
Underweight	33%	33%

Source: Commerzbank Research

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Neutral	14%	0%
Underweight	45%	0%

Source: Commerzbank Research

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