Main Developments in Money Markets and ECB Policy Outlook

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Frankfurt, 18th September 2024

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Agenda: Main Developments in Money Markets and ECB Policy Outlook

1. Expectations for upcoming Governing Council meetings and interest rate expectations going forward, main drivers to watch

2. Expectations on the outcome of the operational framework review

3. Update on the usage of standard refinancing operations, feedback on the alignment of settlement date (MRO/LTRO) since January 2024

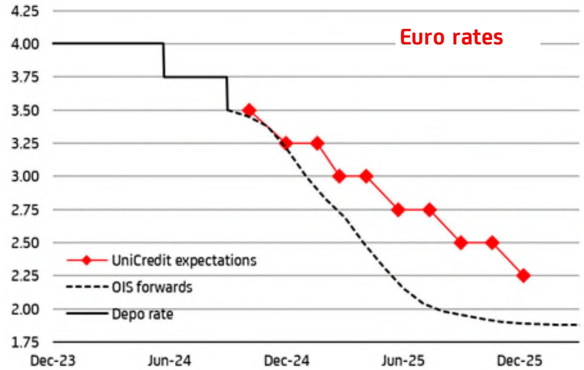
4. Main drivers of recent money market developments (unsecured, secured, commercial paper, FX swap market) and outlook for 2024

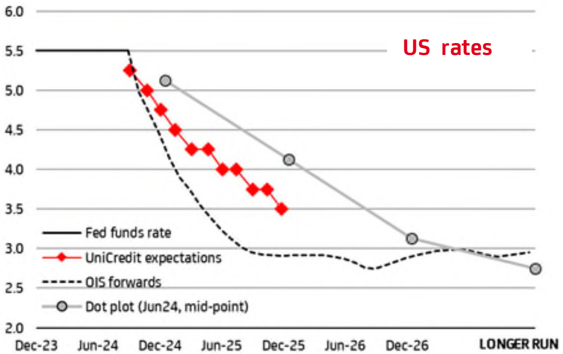
* all values in EUR-equivalent

1 Expectations for upcoming Governing Council meetings and interest rate expectations going forward, main drivers to watch

UniCredit sees rate cuts at a pace of 25 bps per quarter until end 2025 in Europe

- **Monetary policy rates**:
  - Weak US job data in a context of declining inflation drove a strong market repricing down on interest rates
  - Market still perceive a strong correlation between FED and ECB monetary policy
  - As widely expected, ECB cut rates by 25bp in September. OIS market is currently pricing further 33 bps in 24 (25bps in Dec fully priced and 30% prob of 25 bps in Oct) and 125 bps in 25. In US market is pricing approx. 110 bps cut in 24 (OIS market is pricing 40% prob of 50 bps cut in Sep) and approx. 120 bps in 25
  - Unicredit sees rate cuts at a pace of 25bp per quarter until end-2025 in Europe. While in US 75 bp cut in 2024 and 125 bp in 2025





Source: Bloomberg, UniCredit

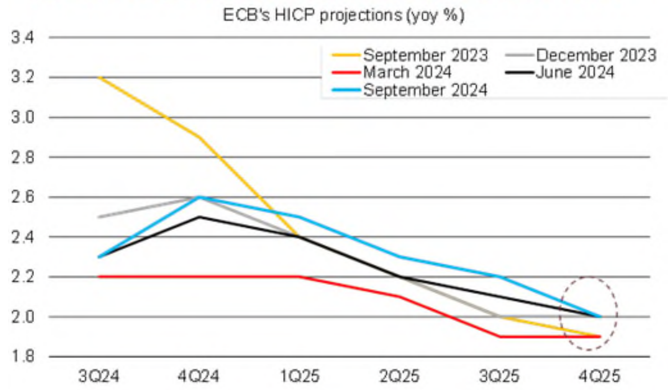
- **Other policy measures**:
  - QT: It is not expected any change of the pace of reduction of the PEPP reinvestments. Full QT from January 25
  - Refinancing operations: Structural longer-term credit operations not yet in the radar screen
  - Minimum reserve requirements: it is not expected any change in the current framework
  - Remunerations of Government deposits: Liquidity parked in central banks is currently very low, it is not expected any change in the current framework

1 Expectations for upcoming Governing Council meetings and interest rate expectations going forward, main drivers to watch

Main drivers to watch: Price stability by end 2025 is key for ECB cuts

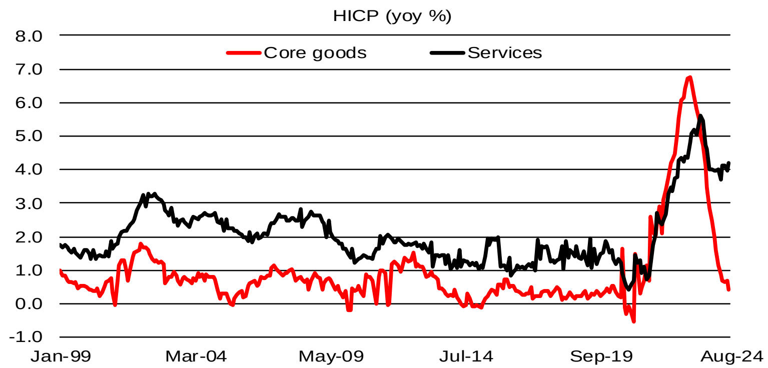
- Most members of the GC think that interest rates will remain restrictive until they reach about 3%, and, until they get there, policy can be set mainly according to the inflation projections
- If the ECB forecasts continue to show a decline in inflation to 2% by the end of 2025, cautious rate cuts remain on track
- Final leg of disinflation expected in 2025, driven by services
- Strong emphasis on the ECB's inflation forecast for 4Q25, which stabilized in the 1.9-2.0% range over the last four rounds of forecasts, giving the ECB enough confidence to start reducing monetary-policy restriction
- If new shocks or upcoming data were to push into 2026 the time when inflation converges with the ECB's target, the GC would likely become more reluctant to cut rates due to the risk of inflation expectations moving higher

All ECB FORECASTS SHOW INFLATION BELOW 2% BY 2026



Source: Bloomberg, ECB, UniCredit

SERVICES INFLATION REMAINS STICKY



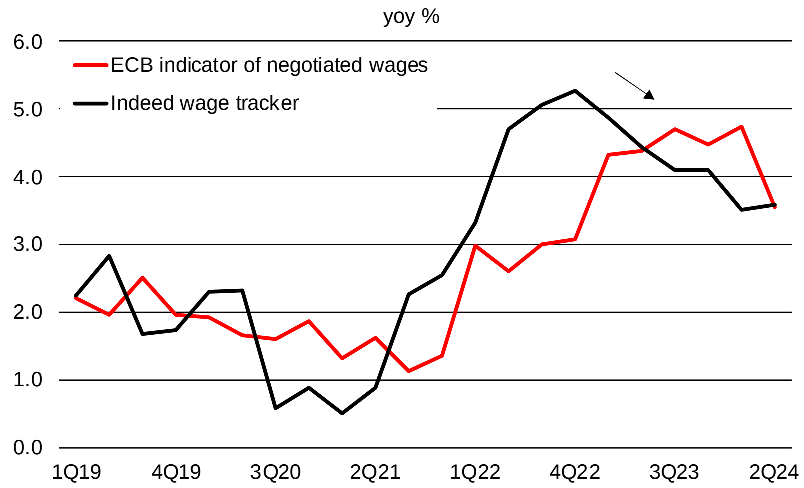
Source: Eurostat, UniCredit

1 Expectations for upcoming Governing Council meetings and interest rate expectations going forward, main drivers to watch

Main drivers to watch: Fast (but slowing) wage growth increasingly absorbed by profit margins

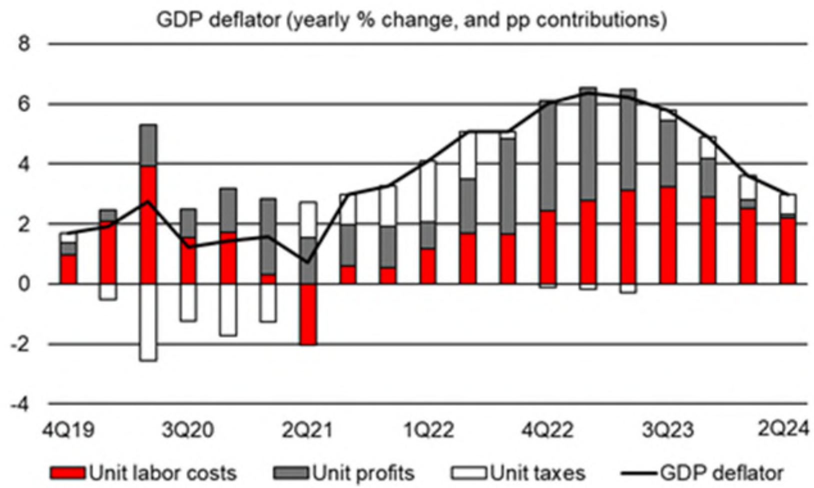
- Strong wage growth remains the key driver of sticky services inflation
- Wage growth has probably peaked. With inflation and short-term inflation expectations down strongly from their recent highs and the labor market cooling down, wage growth will likely moderate materially next year
- Moreover, firms have seen a weakening of their pricing power and are increasingly forced to absorb high labor costs into their profit margins
- The likelihood of a return of inflation to 2% over the course of 2025 increases

WAGES REMAIN CRUCIAL FOR ECB



Source: ECB, Eurostat, Indeed, UniCredit

PRICING POWER OF FIRMS IS WEAKING



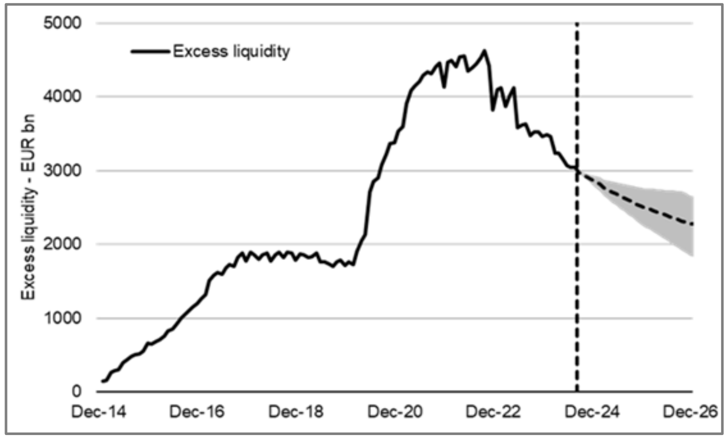
Source: ECB, Eurostat, Indeed, UniCredit

2 Expectations on the outcome of the operational framework review

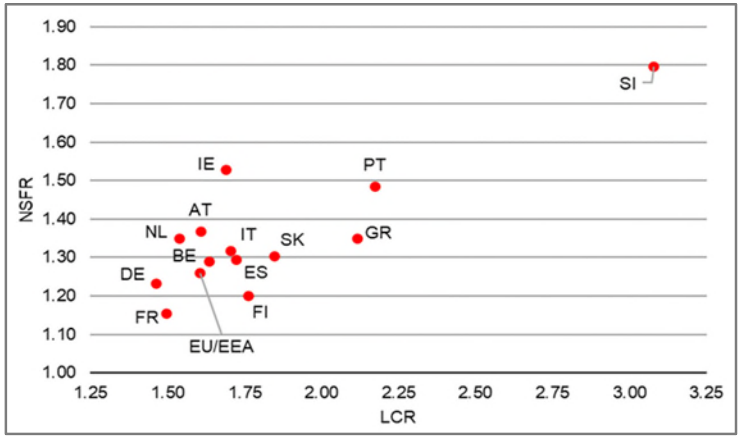
Volumes borrowed of the standard refinancing operations will rise only very gradually

- Excess liquidity is still high at just over EUR 3tn and we expect it to remain well above EUR 2tn until mid-late 2026. Outlook for loan demand is sluggish, which does not put immediate pressure on banks for funding
- The interest for the standard refinancing operations will be more driven by the need for regulatory liquidity than the absolute level of excess liquidity. EBA data indicate LCR levels are satisfactory (at system level)
- the reduction of the spread between deposit rate and the refi rate aims to eliminate the so-called "stigma effect" associated to those operations
- The broad collateral framework backing those standard transactions will incentivize Banks to use Illiquid collateral (Credit Claims) to manage their regulatory liquidity needs
- Market have been discussing about the «appeal» of the new rate applied at MRO and 3M LTRO at Deposit rate + 15bps
- European banking sector is still posting around 1.5 trillion EUR of collateral through ECB Pool. Based on ECB statistics, more than 750bio is represented by credit claims and Asset backed securities which could potentially be ready to use

EUR EXCESS OF LIQUIDITY EVOLUTION



LIQUIDITY REGULATORY RATIOS IN THE EUROZONE



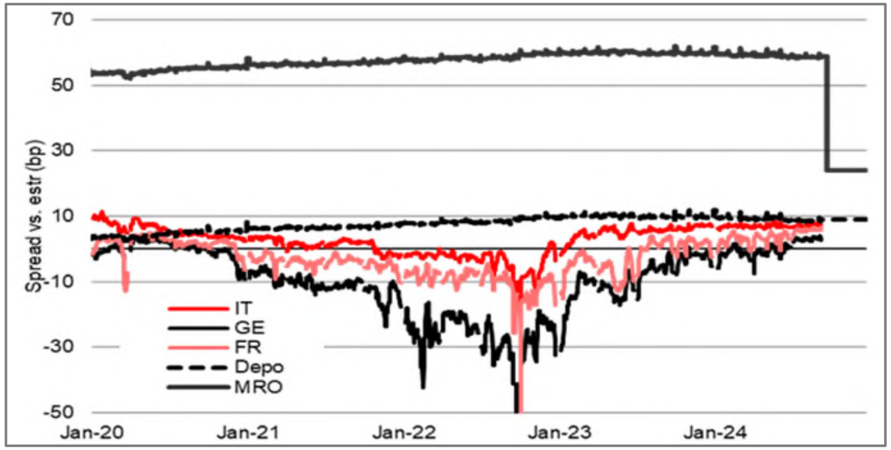
Source: ECB, EBA, Bloomberg, UniCredit Group Investment Strategy

2 Expectations on the outcome of the operational framework review

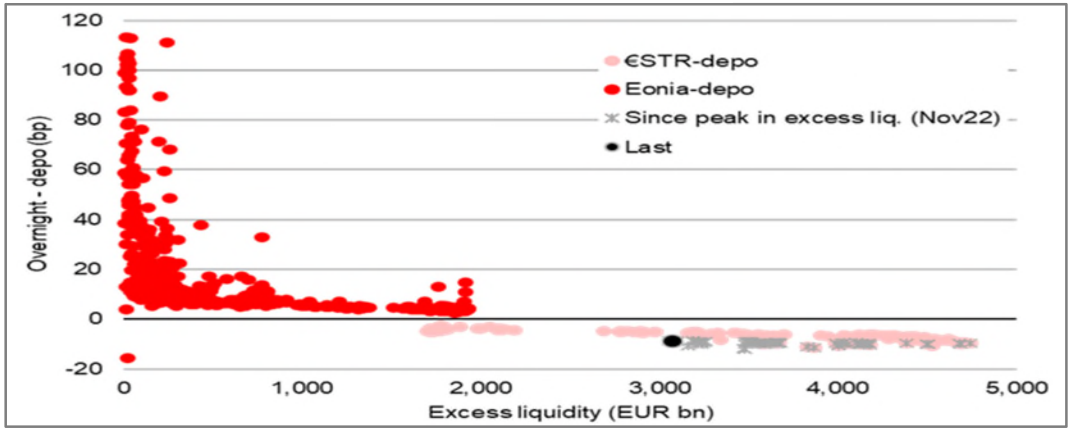
A tighter DFR spread: implications for market rates

- Tighter MRO/DFR spread should be largely neutral for repo rates of sovereigns and other high-quality collateral, which even trade below the DFR. Repo rates for lower-quality collateral likely to be capped at €STR+25bp
- Incentive for banks to fund lower quality collateral via MRO if repo rates are higher, but stigma effect difficult to evaluate ex-ante (probably less relevant for smaller banks)
- New ECB framework should help to mitigate potential spikes of Euribor-OIS basis

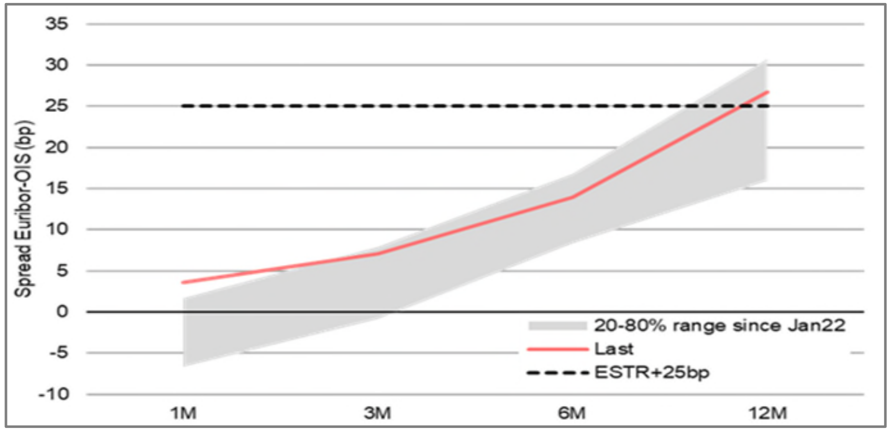
REPO RATES FOR HQLA TRADE WELL THROUGH THE MRO RATE



EUR OVERNIGHT RATES STILL UNELASTIC TO EXCESS OF LIQUIDITY



POTENTIAL OISBOR SPREADS' SPIKES LIKELY TO BE MITIGATED



Source: ECB, Bloomberg, UniCredit Group Investment Strategy

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Update on the usage of standard refinancing operations, feedback on the alignment of settlement date (MRO/LTRO) since January 2024

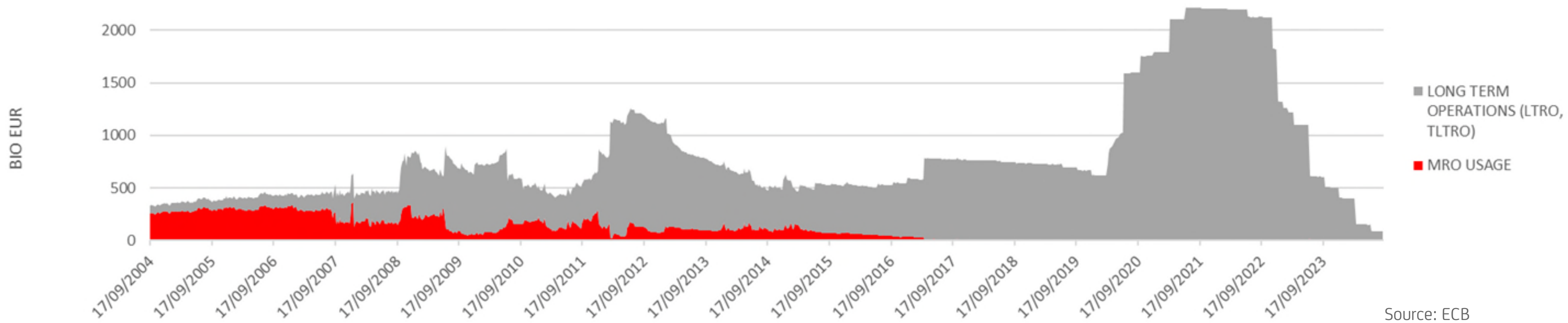
- In a context of excess liquidity, still limited usage of standard refinancing operations but their volume marginally increased on the back of maturities of the various tranches of the TLTROs

- The so called "stigma effect", related to the pricing of the standard refinancing operations well above the secured funding market levels, still preventing most of the players to use those facilities as an ordinary liquidity management tool

- With the introduction of the new ECB operational framework, we potentially expect an increase of the standard refinancing operations volumes mainly backed by non-HQLA collateral

- The alignment of the settlement dates has been welcomed by the market making easer the switch between MRO and LTRO thus improving the liquidity management activity

MRO USED TO BE A SIGNIFICANT FUNDING INSTRUMENT BEFORE LONG TERM OPERATIONS



Source: ECB

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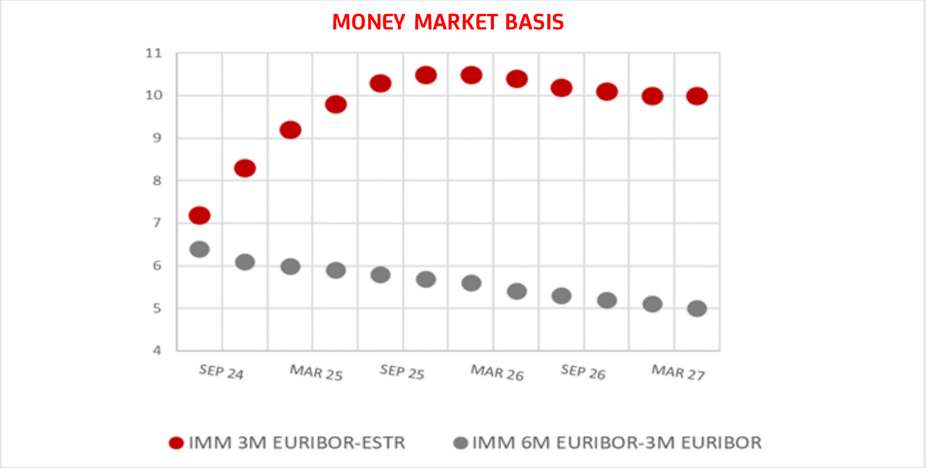
4 Main drivers of recent money market developments (unsecured, secured, commercial paper, FX swap market) and outlook for 2024

Liquidity Markets

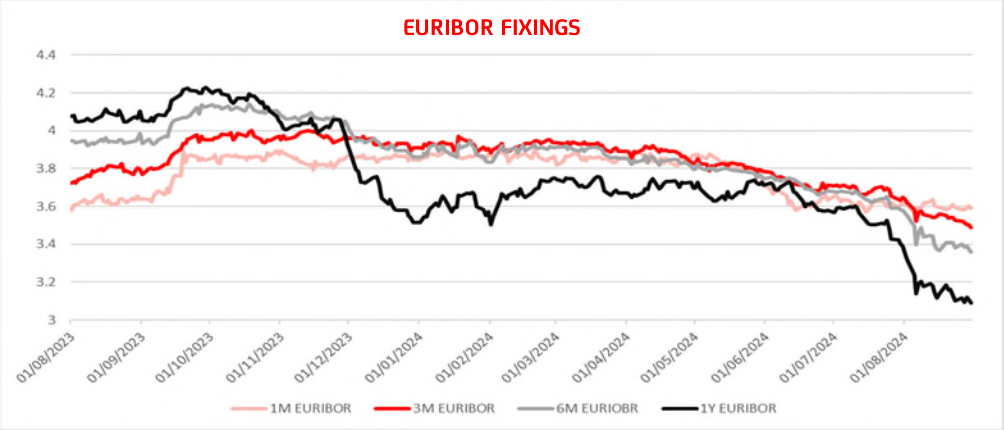
- Euribor Fixings have been moving accordingly with market expectations on rates' development, which –after the first 25bps rate cut- are currently pricing more than 150bps rate cut before the beginning of 2026

- Embedded liquidity premia, have been looking stable in the comparison with respective OIS ESTR rates. The gradual normalization of liquidity, can be observed by 3M Euribor fixings consolidating close to the equivalent level of ECB Depo facility

- With the current environment of Excess of Liquidity (>3000 BN EUR), liquidity spreads look definitely stable. (3M-EURIBOR vs €STR basis and 6M-3M Euribor basis)



Source: Bloomberg



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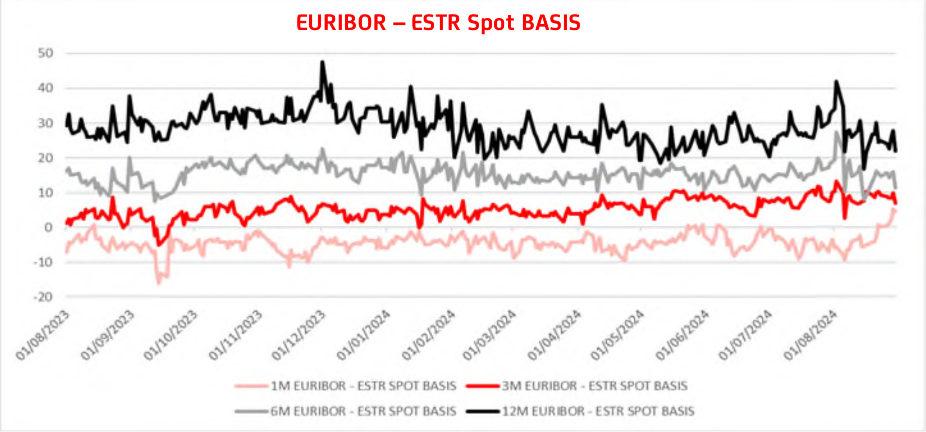

Source: Bloomberg

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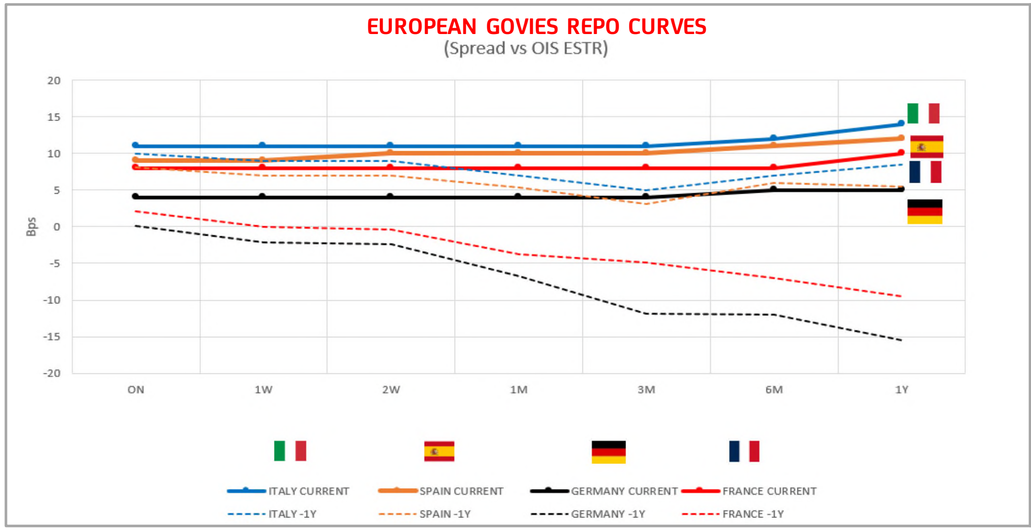
Main drivers of recent money market developments (unsecured, secured, commercial paper, FX swap market) and outlook for 2024

Availablity of Collateral & Repo Markets

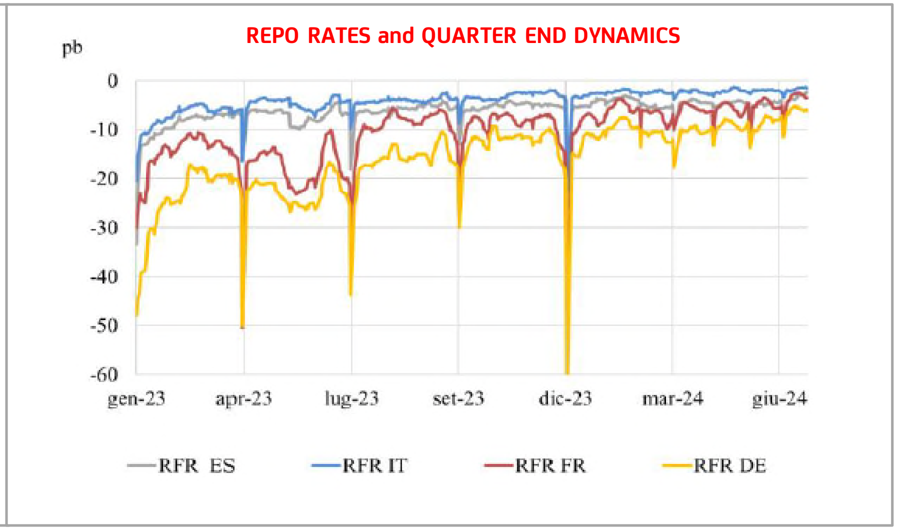
- During Q2 and Q3, European repo curves have been consolidating in a tighter range. For 3M tenors, the entire GC European repo market is between ESTR + 4bps (GER) and ESTR + 11bps (ITA)

- In the 1Y comparison:
  - Italian and peripheral repo consolidated around the level of the deposit facility on day-by-day activity with smooth circulation of liquidity
  - Core REPO curves massively tightened vs peripheral ones on the back of TLTRO repayments and reduction of reinvestment of PSPP and PEPP.
  - Collateral scarcity and reporting dates dynamics have evaporated.
  - Repo curves turned into having a «slight» positive slope vs ESTR curve, thus signalling a more cash-driven approach to the repo market

- Repo markets have moved from collateral-driven to cash-driven



Source: UniCredit

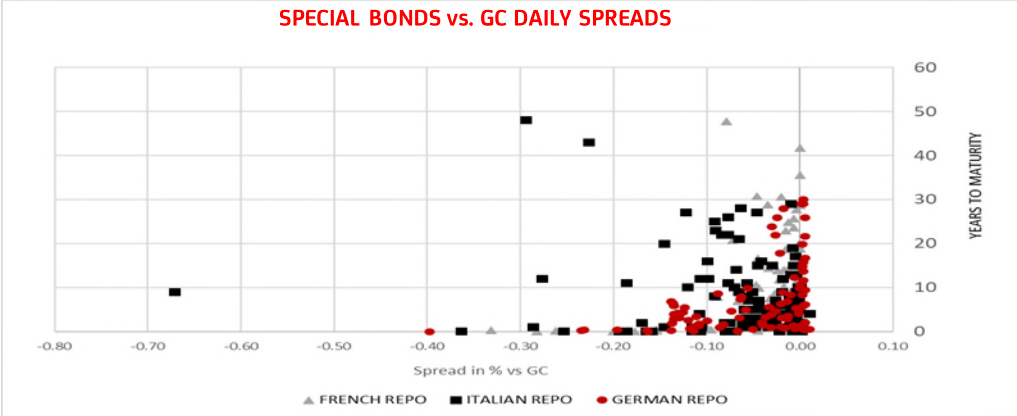


Source: Bank of ITALY

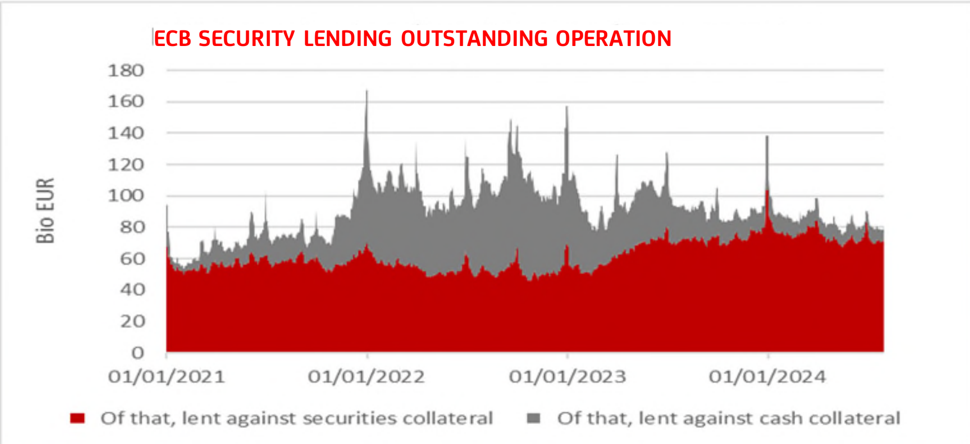
4 Main drivers of recent money market developments (unsecured, secured, commercial paper, FX swap market) and outlook for 2024

Collateral availability reduced special bonds

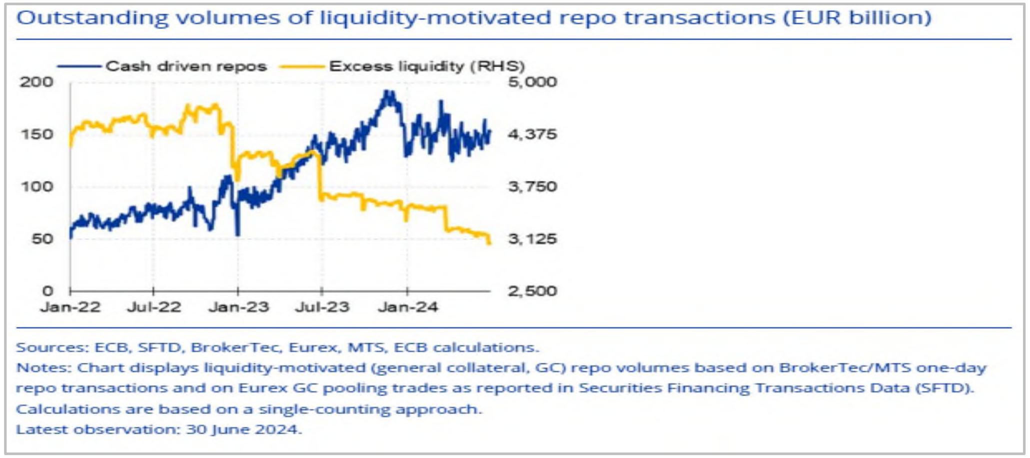
- Number of «SPECIAL» bonds have slumped on the back of:
  - Re-sizing of short positions and expectations of rate cut
  - Evaporation of collateral scarcity pressures
  - Stabilization of government bonds' spread
  - Main part of specials bonds are BILLS, due to: lower outstanding; higher deman from MMFs; higher demand from retail investors (BOT people).
- Reporting dates pressures have been softening with broader collateral availability and reduction of banks balance sheets



Source: MTS & BROKERTEC



Source:ECB



Source:ECB*

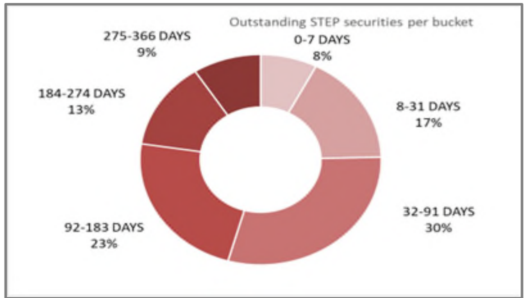
Source:ECB* / Repo markets: Understanding the effects of a declining Eurosystem market footprint - https://www.ecb.europa.eu/press/blog/date/2024/html/ecb.blog20240723~d41a28a404.en.html

4 Main drivers of recent money market developments (unsecured, secured, commercial paper, FX swap market) and outlook for 2024

Unsecured Markets

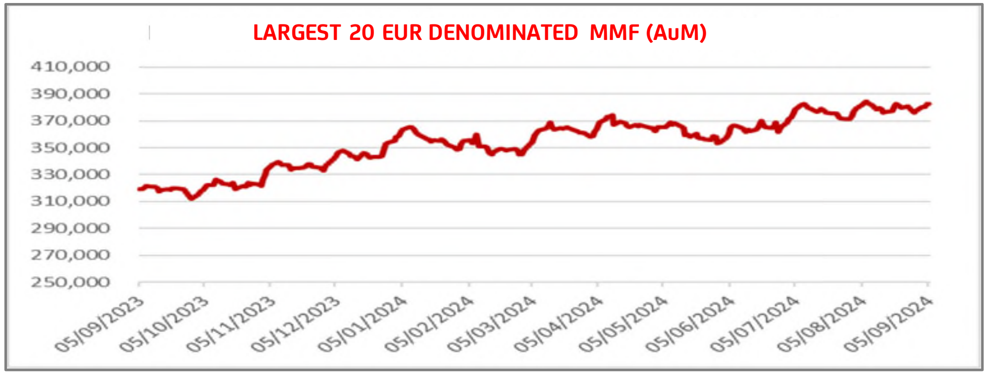
- During Q2 and Q3, AuM of Money market funds kept increasing on the back of negativly sloped interest rate curves and stable credit spreads. The dynamic was very similar both for EUR and USD
- Short term EUR mmF reached historical high in terms of AuM
- Flattening of curves have fuelled the demand for short terms instruments, which given government issuance activity, was filled mainly by banks through unsecured (CD & CP) and secured instruments. This is confirmed by the behaviour of STEP securities outstanding volumes
- WAM of MMFs investements slightly declining, signalling preference for super short term, and keeping greater part of volumes within 6M tenor
- Liquidity coming from the MMF only partially balanced some of liquidity drains arising from TLTROs repayments
- Liquidity premia remained stable vs equivalent OIS ESTR levels

STEP OUTSTANDING VOLUMES PER MATURITY



BUCKET	OUTSTANDING in MIO Eur
0-7 DAYS	36,383
8-31 DAYS	81,374
32-91 DAYS	142,308
92-183 DAYS	110,363
184-274 DAYS	64,363
275-366 DAYS	43,626

Source: STEP Database



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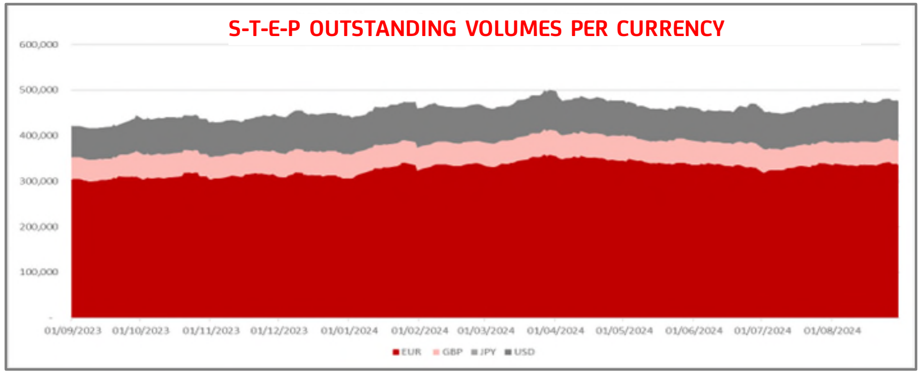

Source: STEP Database