ECB BMCG Market Update

Christoph Rieger, 15 September 2021
Higher inflation – lower rates… at first!

Key developments since our last meeting:

- 8 July: Results of Strategy Review
- 22 July: New FG on interest rates
- 24 August: Lane interview
- 31 August: HICP jumps to 3%
- 9 September: PEPP with “moderately lower pace”

Strategy review initially pushes back rate expectations despite higher inflation expectations…
Change in 3y3y €STR and ILS forward since strategy review and Lane interview, in bp

… but convergence is not yet complete!
2y1y forward/forward inflation at the time of lift-off (when first 10bp ECB depo rate hike was fully priced in), calculated from ILS adjusted for 8bp average ex-tobacco spread, in %

Source: Bloomberg, Commerzbank Research

20 September 2021
ECB stays in control!

As ECB tries to cap nominal yields, real yields hit record lows!

GDP-weighted € sovereign yield curve, nominal and real yields (average nominal yield minus inflation swap), in %

Joint assessment of financing conditions and inflation outlook:

Favourable financing conditions “can be maintained with a moderately lower pace of net asset purchases” under the PEPP than in the previous two quarters.

(ECB decision on 9 September)

Source: ECB, Bloomberg, Commerzbank Research
Projections hold the key!

Right direction, but still missing the target!
2023 ECB inflation projections and market forwards*, in %

ECB could be too optimistic on Q4 GDP!
ECB projections for euro area real GDP, Sep-21, q/q in %

*) using ILS on headline HICPx, adjusted for 8bp ex-tobacco difference and 3m lag in reference index. Forwards are calculated at cut-off date of ECB projections

Source: ECB, Bloomberg, Commerzbank Research
Discussion points:

- How would the market react to a wind-down of the PEPP until the end of March 2022?
- Are spreads exposed if the APP cannot inherit flexibility from the PEPP?
- Would it enhance transparency if the ECB communicates the intended monthly purchase pace of the PEPP?
- What will be the impact on issuance and spreads from the ECB climate change action plan?
- Should TLTROs become a permanent feature?
- How should the TLTRO and tiering parameters be recalibrated?
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I) Recommendations versus benchmarks:

Overweight (OW) We expect outperformance versus the benchmark in spread and/or total return terms
Marketweight (MW) We expect performance in line with the benchmark in spread and/or total return terms
Underweight (UW) We expect underperformance versus the benchmark in spread and/or total return terms

Benchmark: Unless stated otherwise, the benchmark is the iBoxx € Corporate for IG-rated names/instruments, and the iBoxx € High Yield core cum crossover LC for HY-rated names/instruments

II) Outright recommendations:

Buy We suggest entering / expanding positions in the relevant names/instruments
Sell We suggest reducing / closing positions in the relevant names/instruments

Time Horizon: Unless stated otherwise, the time horizon for our recommendations is three months.

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17/03/2021
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<table>
<thead>
<tr>
<th>All covered instruments</th>
<th>The proportion of issuers in each of these categories for which Commerzbank provides investment banking services</th>
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<tr>
<td>Overweight</td>
<td>36%</td>
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<tr>
<td>Marketweight</td>
<td>44%</td>
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<tr>
<td>Underweight</td>
<td>20%</td>
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Source: Commerzbank Research

Distribution of Commerzbank AG rates research recommendation as of 31 December 2020

<table>
<thead>
<tr>
<th>All covered instruments</th>
<th>The proportion of issuers in each of these categories for which Commerzbank provides investment banking services</th>
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<tbody>
<tr>
<td>Long/Buy</td>
<td>56%</td>
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<tr>
<td>Neutral</td>
<td>29%</td>
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<tr>
<td>Underweight</td>
<td>15%</td>
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Source: Commerzbank Research

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