EGB MARKET OUTLOOK
BMCG-ECB
10 NOVEMBER 2022

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Eurozone looks set to suffer a significant degree of permanent scarring on the back of the energy shock.

- **A eurozone recession is inevitable.** A combination of domestic and global headwinds look set to put the eurozone into recessionary territory. Fiscal policy support should prevent a deep one, but we expect a prolonged period of sluggish activity, with below-trend growth throughout 2023–24.

- **A regime shift in inflation is underway.** Inflation shock to be persistent. While headline inflation will ease significantly next year – primarily reflecting base effects from energy – underlying inflation is set to remain sticky. Wage growth is likely to continue to build despite the recession.

- **ECB: a more cautious stance but takes rates into ‘restrictive’ territory.**
  - Expected downshift in the pace of tightening in December, from 75bp to 50bp,
  - But the DFR is expected to reach 3.00% by end-Q1, consistent with rates moving into ‘restrictive’ territory.
  - The ECB is set to announce the key principles behind QT at the December meeting. Ending full reinvestment looks more likely than outright sales. Our central case is for QT beginning in H1 2023.
EGB market review

10y Bund yield and deposit rate since 1999

Sources: Bloomberg, BNP Paribas

Realized volatility coming down but still on very high levels

Sources: Bloomberg, BNP Paribas

10s30s some resistance around 2% for the 30y

Race to neutral not over for the ECB: Upward pressures due to the hiking cycle will likely be reinforced by discussions about quantitative tightening at upcoming meetings, and high net supply in Q1 2023.

How long those pressures last depends on how far into restrictive territory the ECB goes – as the ‘neutral’ rate has not been reached, we expect higher yields in the near future (we forecast the 10y Bund yield to approach 3% in Q1 2023).

Curve direction: two opposite forces on 2-10y spreads
- flatter ahead of recession and US curve likely to invert further as the market prices in a longer and higher cycle after the Feb last week
- steeper on the back of higher net supply ( gross supply to remain elevated and introduction of QT)
2023 EGB supply outlook

### 2023 supply projections (EURbn)

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<th>2023 gross supply</th>
<th>2023 net supply</th>
<th>2022 gross supply</th>
<th>2022 net supply</th>
<th>Chg in gross supply</th>
<th>Chg in net supply</th>
<th>Chg in 2023 net supply vs 2022 net supply net of QE</th>
<th>2023 net supply net of QT assuming 50% roll-off, starting in Jan</th>
<th>2023 net supply net of QT assuming 50% roll-off, then 100% in Jul</th>
<th>2023 net supply net of QT assuming 50% roll-off, starting in Apr</th>
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### Eurozone gross supply over time (EURbn)*

### Eurozone net supply over time (EURbn)*

*Excludes Greece. Sources: National treasuries, European Commission, Bloomberg, BNP Paribas
Discussion points

1. How big is the risk of a long and durable stagflation worldwide.
2. Is the deterioration of market depth and liquidity temporary or structural (without QE, more limited capacity for intermediation and more regulations)
3. How implements active QT without resulting in another huge selloff – BoE example?
4. Is the failed auction in Germany in October (new 7y Bund) a one-off or a trigger to change issuing models (new environment, coming QT and remaining important borrowing needs from sovereigns)
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