ECB Money Market Contact Group

A. Main developments in money markets and ECB policy outlook

Frankfurt, March 14th 2024, Oliver Deutscher
Operational Framework Review – Excess Liquidity slowly shrinking

In the future, money market prices are likely to move away from the deposit rate

Source: Bloomberg; DZ BANK
Market sharply withdraw on expectations of ECB’s policy lowering rates early in 2024

DZ forecast has been more conservative due to geopolitical and inflationary developments and environment

Forwards pricing in interest rate downward cycle to start by June’24 with est.-25bp and up to further -75bp by EoY 2024 (new baseline 3%)

As of now, no material impact seen in rates, market depth and liquidity stemming from maturing TLTRO III’s (i.e.December’23 repayment) and March’24 maturity.

Money markets functioning very well over the short term yield curve.

Large investor appetite in money market investment spectrum due to higher rates and staying clear in the shorter end before having clearer view outlook

Very positive developments in traded volumes and market depth also seen throughout in European Repo Markets

ECB deposit facility volume as of 23.Feb.24 at: +3.524Bln

Source: Bloomberg; DZ BANK forecast / *OIS from Jan 24 – Feb 24
We expect the central bank to look thoroughly through correlations
Mixed Money Market effects from QT and rates effects (I/ II)

- Developments in the unsecured market and recent upward moves in €STR?
  - Funding needs increasing across the curve, in some parts less liquidity placed in ON deposits though not yet really seen in €STR Volumes
  - Possible increased funding demand due to balance sheet reduction of ECB

- Any changes seen in €STR pricings due to lower excess liquidity developments?
  - Not yet foreseen, as excess liquidity seems still abundant
  - Relative stable €STR level around +/- 2bp with a mean value of €STR at 3.905% for 2024 or DFR-10bp reflecting excess liquidity
  - Current Min.Res.Requ.(MRR) of 1% at 0% manageable and not yet fully distributed to relevant client pricing (i.e.-5bp)
  - Though change in MRR >1% will impact short term rates and €STR to a far larger extent
  - If MRR changes, re-pricing on MRR liabilities expected impacting €STR
    - a.) rates
    - b.) traded volume and possible additional shift in repo markets (as not relevant for MRR calculations)

- Any indication of €STR being influenced by upward move in repo rates?
  - €STR as pricing benchmark (i.e.hedging) for repo markets
  - Increased volume of free floating GC collateral in context of decreasing TLTRO’s lead to increased repo funding volumes and GC repo rates
  - Good liquidity and investment appetite by investors which do not access central bank, leaves profitability opportunities open

Source:
Major participants in Money Markets?
- Specific Corporate clients and Financials driving €STR relevant volumes with a high proportion of transactions with institutions who do not have/use access to deposit facility
- In addition our (DZ BANK Verbund Clients) to some extent in ON Deposits,
- Excess liquidity still high but due to stronger expected regulation higher/increased demand for liquidity reserves held as buffer (i.e.: EurexClearing AG Change to min.40% Cash Collateral since Jan.2nd 2024 effective)

DFR and €STR developments in context of lower excess liquidity levels due to QT?
- Yes, ESTR should move in direction of DFR once excess liquidity volume narrows and QT further tightens
- Possible effects stemming from a potential “demand driven floor system by ECB” should add to above mentioned thesis, €STR moving towards DFR
- Question could be, where upper and lower bound of new monetary policy framework will be seen and set in future …
- and bigger banks balance sheets lead to increasing demand for long term liquidity /assets

€STR still relative stable due to i.e.:
- Money Market in very good shape due to new and additional inflows of investors…
- In specific since last year, as domestic reserve remuneration changed (i.e. Dt. Bundesbank) to 0%, and liquidity diverted into money markets and to good rated institutions.
- Additionally, investors more sensitive to good short term rating and credit evaluations as awareness increased after SVB/USA, UBS/CSFB volatilities

Majority of impacts in unsecured overnight market and its distribution between €STR-relevant MMSR flows seem mainly being based on i.e.:
- Constant liquidity inflows from corporate treasuries
- Financials and probably savings and co-operative client flows

Source:
End of Year'24:
- ESTR: 3.882%
- German GC -41bp
- Spain GC -4bp
- France GC -33bp

Eo January'24:
- ESTR: 3.894%
- German GC -3bp
- Spain GC +2bp
- France GC -1bp

Eo February'24:
- ESTR: 3.887%
- German GC -20bp
- Spain GC flat
- France GC -22bp

Eo Feb': MRR 56days
- April: MMR 42days
- May: MMR 56days

Source: CMG Group Benchmark Admin., RFR rates CME Repo Backes Benchmark. Based on centrally cleared repo trades on either BrokerTec and MTS, trades sovereign bonds Eurozone
Overview EURO GC Pooling Baskets vs. ESTR Spread & Volumes

Spread difference peaks on month ends though less significant in 2024 vs. 2023

Source: Bloomberg, DZ BANK
Annex:
Use of marketable and non-marketable collateral

Credit Claims
Peak Q2’22 at 925 bln

Outstanding credit: 510 bln Q.4 2023 vs. high Q.3 2021/2230 bln (-77%)
- Eurozone Average at 95%
- Highest Finland: 152,1%
- Lowest Cyprus: 52,2%

and i.e. as:
- Germany: 98,7% = > temporary increases reflecting Corona-crisis
- France: 102,9%
- Italy: 79,1% = > fairly stable on average even through and post Corona-crisis
Central bank members pay more attention to wage trends
Wage pressure should at least not accelerate any further

In percent

Employment expectations over the next 3 months*

Source: Bloomberg; DZ BANK
Geopolitical risks: Conflict in the Middle East harbours risks

Oil price development with potential upside risks

Oil price development and key drivers (Brent, USD/barrel)

- Actual production cut Saudi Arabia (1 million b/d) and announcement for August
- OPEC+ announcement: Production cut from May
- Announcement OPEC+: Production cut from 01/2024
- Hamas attack 7/10/23
- Foundation of the "Operation Prosperity Garden" against Huthi attacks (18/12/23)
- Concerns about prolonged high interest rates and recession-related decline in demand
- Discussion about Gaza arms standstill
- 1st Huthi attack in the Red Sea 19/11/23

In US-Dollar / Number of Ships (R.S.)

- Freight costs: 40-foot container from Shanghai to Rotterdam
- Container Ship Crossings (Suez Canal) (R.S.)

Source: Bloomberg; DZ BANK