

14 SEPTEMBER 2022

THE TRANSMISSION OF ECB RATE HIKES TO MONEY MARKETS IN THE EUROZONE : WHAT CAN WE EXPECT WHEN RATES WILL RISE IN POSITIVE TERRITORY ?

**PRESENTATION TO THE ECB MONEY MARKET
CONTACT GROUP**

Ileana Pietraru

Global Head of Short-Term Treasury

SOCIETE GENERALE

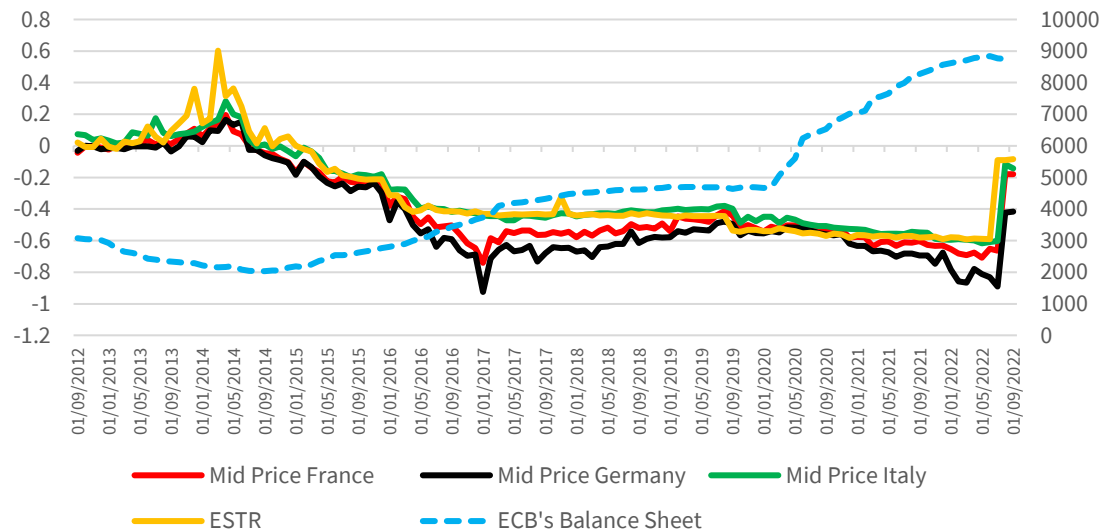
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HISTORICAL DATA SHOWS EVIDENCE OF HOMOGENEOUS RATE MOVES ACROSS INSTRUMENTS FOR THE PAST DECADE

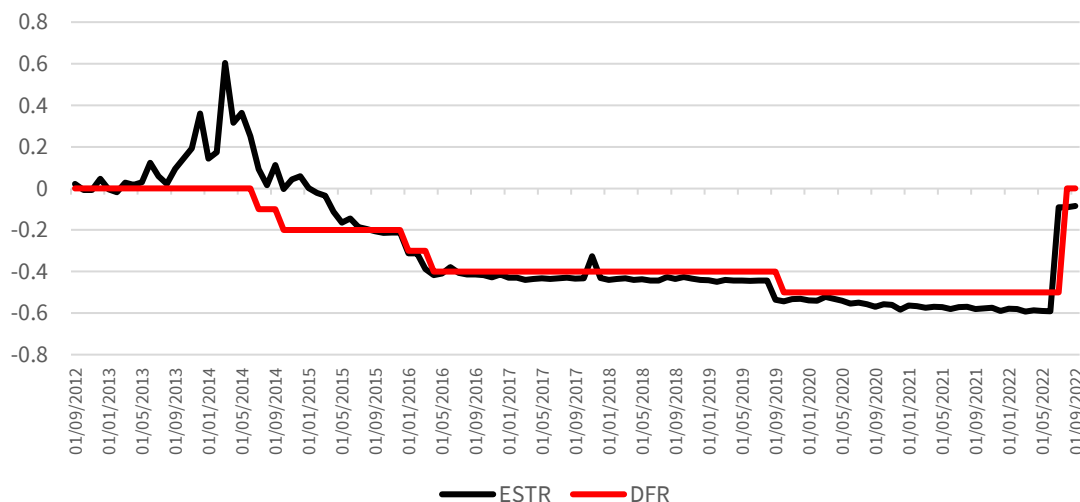
➤ **REPO GC RATES AND ESTR MOVED CONSISTENTLY WITH DFR**

➤ **DUE TO INCREASES IN ECB'S BALANCE SHEET SINCE 2016, WE HAVE WITNESSED SOME VOLATILITY ON REPO RATES AND A DECREASE OF ESTR COMPARED TO DFR**

GC rates, ESTR and ECB's balance sheet



Spread ESTR/DFR

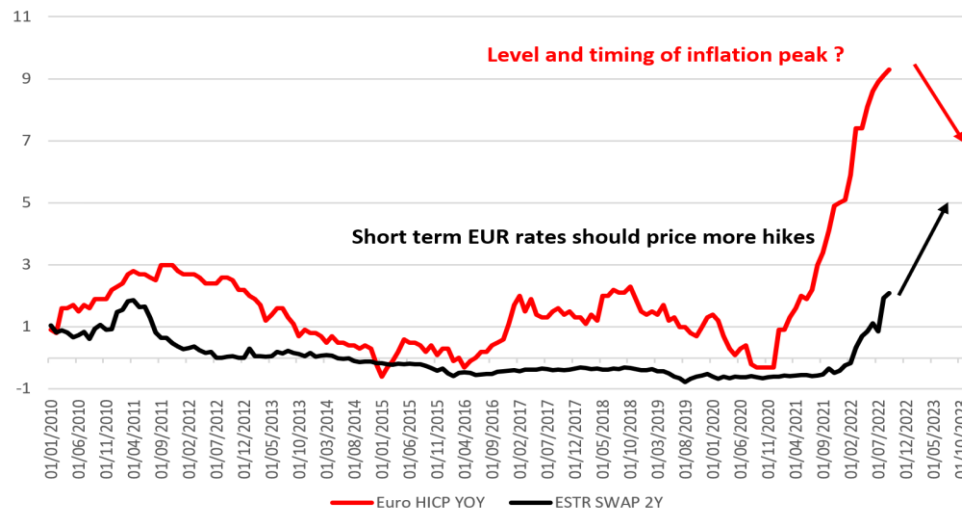


INFLATION PATH IN THE EUROZONE MAY CALL FOR MORE RATE HIKES THAN WHAT IS PRICED TODAY

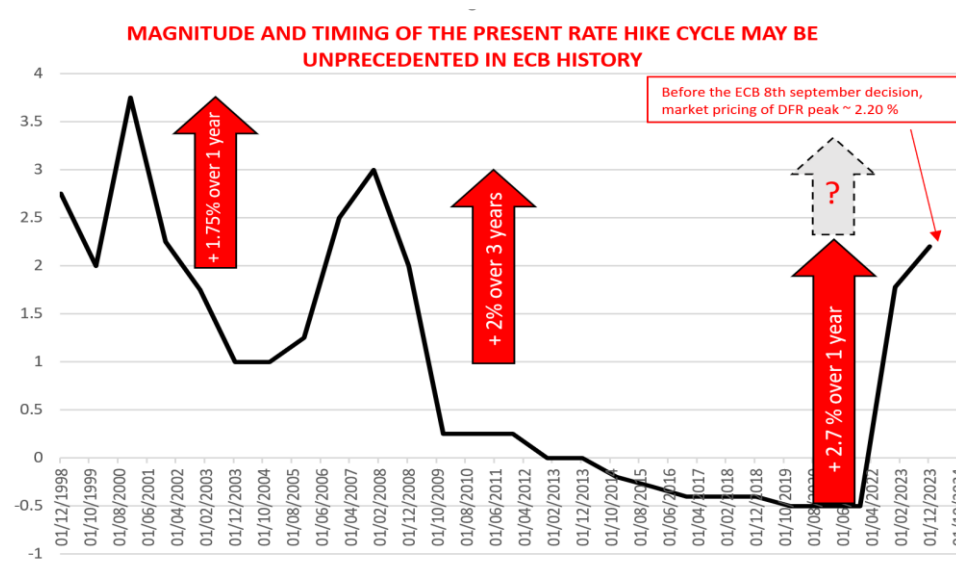
➤ **LEVEL OF INFLATION PEAK MAY PROVE HIGHER, DECREASE TOWARDS THE 2% TARGET SLOWER THAN ANTICIPATED**

➤ **THE MAGNITUDE AND TIMING OF THE PRESENT CYCLE MAY PROVE UNPRECEDENTED**

EUR Short rates vs core inflation : more room for ECB action

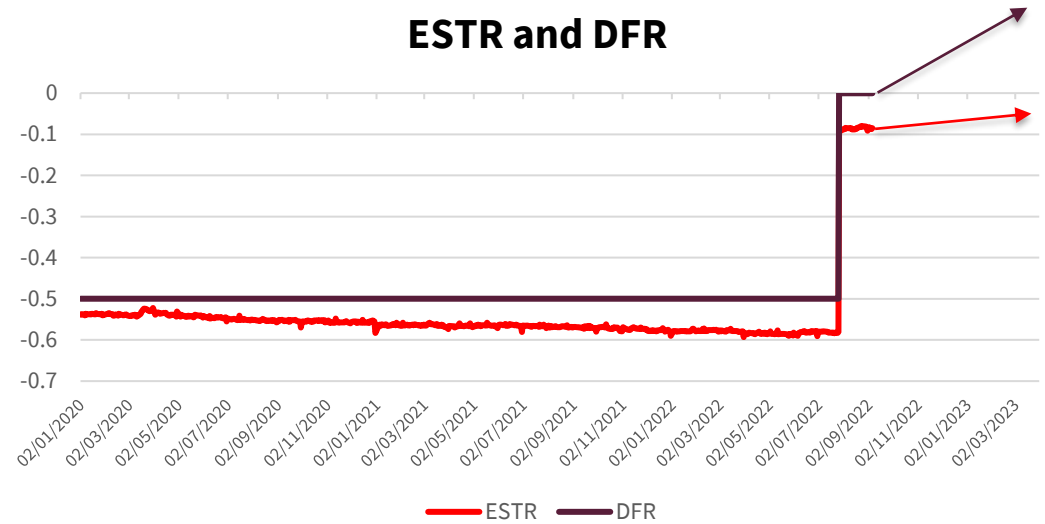


MAGNITUDE AND TIMING OF THE PRESENT RATE HIKE CYCLE MAY BE UNPRECEDENTED IN ECB HISTORY

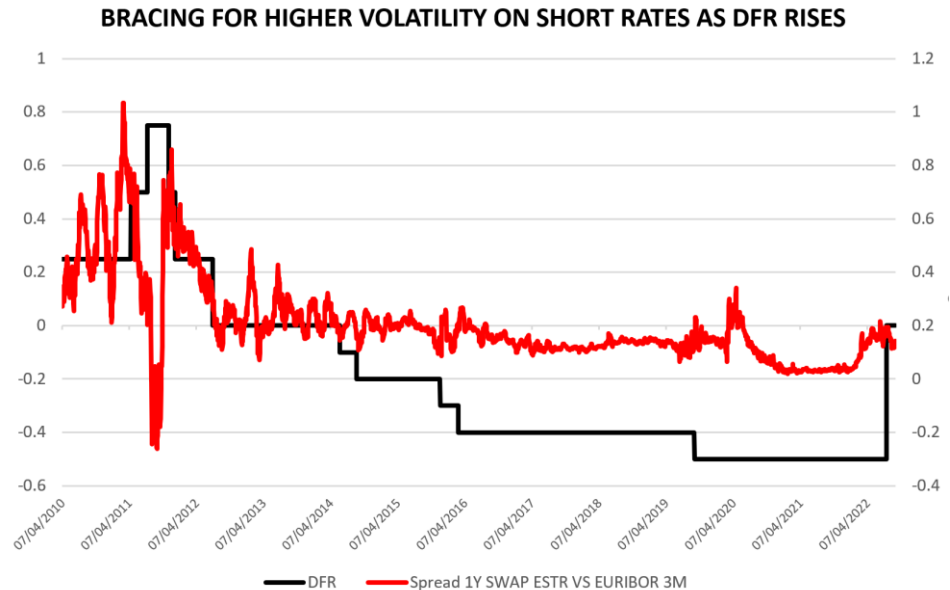


SIGNS OF BROKEN TRANSMISSION OF MONETARY POLICY TO MARKETS ? THE UNSECURED FUNDING SEGMENT

➤ **THE ESTR/DFR SPREAD MAY WIDEN AND BECOME MORE VOLATILE**



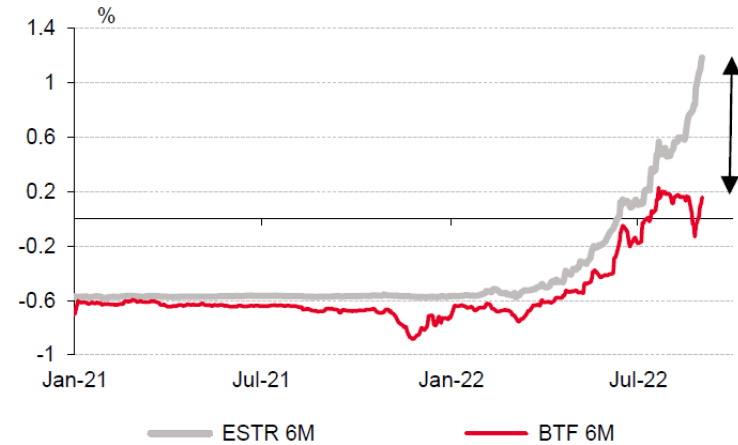
➤ **WHILE THIS VOLATILITY SPREADS TO UNSECURED FUNDING AND TO DERIVATIVES**



SIGNS OF BROKEN TRANSMISSION OF MONETARY POLICY TO MARKETS ? CORE COUNTRIES GOVERNMENT SHORT TERM DEBT YIELDS UNDER DOWNWARD PRESSURE

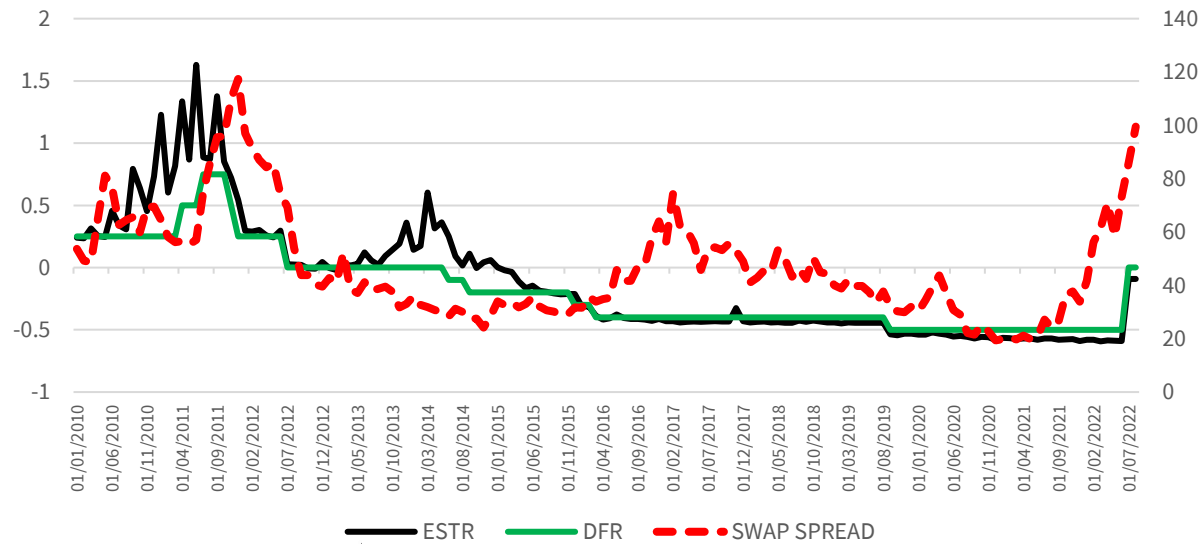
- **DISRUPTIONS SEEM TO APPEAR AS SHORT-TERM INTEREST RATES ENTER POSITIVE TERRITORY, AS SHOWN BY THE RECENT DIVERGENCE BETWEEN CORE COUNTRY BILL YIELDS AND INTEREST RATE SWAPS**
- **2Y EURO ASSET SWAP REACHED EXTREME 2008 AND EVEN 2011 LEVELS, ALTHOUGH ABSOLUTE RATES AND LIQUIDITY CONDITIONS ARE DIFFERENT TODAY**

Swap ESTR 6M and BTF 6M



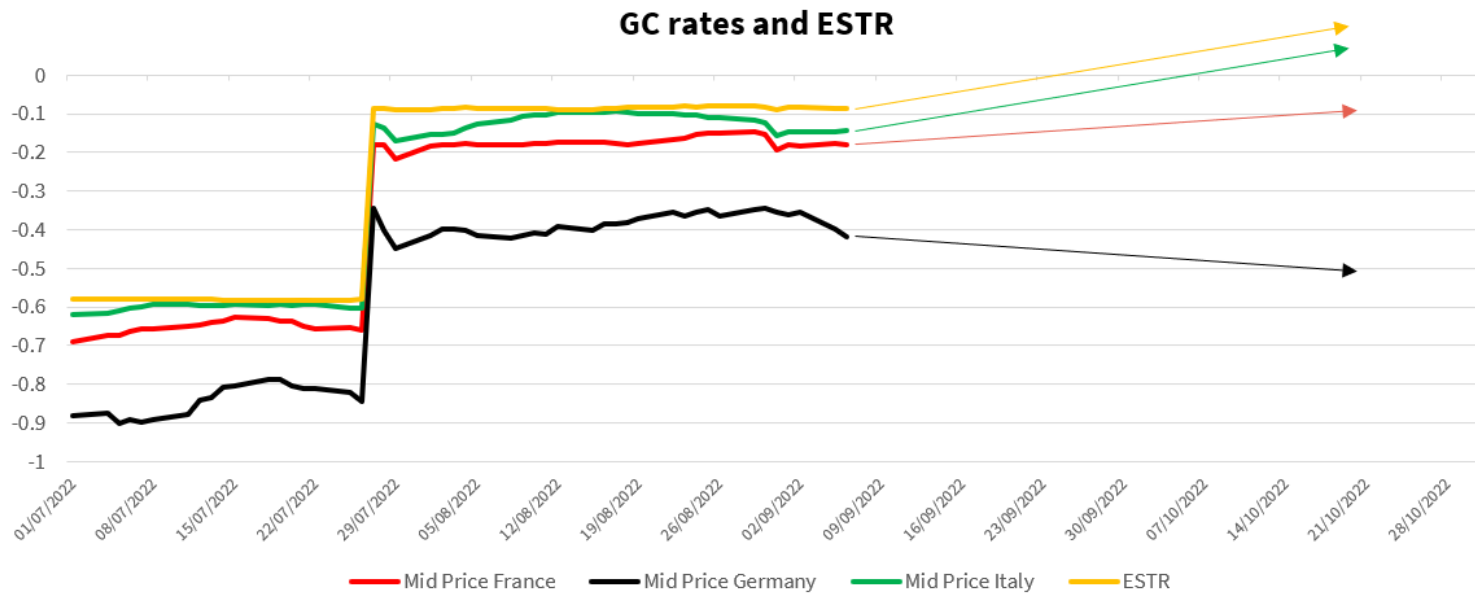
SG Cross Asset Research/Rates, Bloomberg

Swap spread Schatz/Swap 2y vs EIB 6m



SIGNS OF BROKEN TRANSMISSION OF MONETARY POLICY TO MARKETS? LOW PASSTHROUGH OF RATE HIKES TO REPO RATES

- **ECB WORKING PAPER PUBLISHED AUG 11 : "MONETARY TRANSMISSION IN SEGMENTED MARKETS" POINTS TO INEFFICIENT AND UNEQUAL PASSTHROUGH OF ECB'S POLICY RATE IN REPO MARKETS**
- **GERMAN REPO SHOULD MOVE BY 15 BP LESS THAN THE DFR IN CASE OF A 75 BP RATE HIKE DECISION ON SEPTEMBER 8TH (PASSTHROUGH RATE OF 80%)**



FIXING THE LOW PASSTHROUGH OF RATE HIKES TO REPO RATES ?

- **A NEW OVERNIGHT REVERSE REPURCHASE AGREEMENT FACILITY TOOL SIMILAR TO THE FED'S RRP MAY BE REQUIRED. THIS FACILITY COULD HAVE THREE PURPOSES :**
 - **KEEP REPO RATES IN LINE WITH DFR**
 - **ALLEVIATE SOME COLLATERAL SCARCITY ISSUES , BY INCREASING THE OFFER OF COLLATERAL FROM THE EUROSYSTEM**
 - **DECREASE THE EXCESS LIQUIDITY, DEFINED AS THE BANKS' EXCESS RESERVE HOLDINGS AT CURRENT ACCOUNTS AND THEIR USAGE OF THE DEPOSIT FACILITY**

- **HOWEVER, THIS COULD PROVE OPERATIONALLY COMPLICATED AND MAY NOT FIX THE STRONG DEMAND FOR CORE COLLATERAL AND THE MARKET FRAGMENTATION**

GOING FORWARD IN UNCHARTERED ENVIRONMENT : WHAT RISKS DO WE FACE ? 1/2

- **RISK OF HIGHER VOLATILITY AND THEREFORE HIGHER DISRUPTION, COULD IMPAIR THE ANALYSIS OF THE EFFECTS OF MONETARY POLICY ON MONEY MARKETS**
- **RATES INCREASING MAY HAVE DIFFERENT EFFECT THAN WHAT WE EXPERIENCED IN THE PAST DUE TO A TOTALLY NEW ENVIRONMENT**
- **Possible reliance of banks' funding and ratios on TLTRO III or in case of carry trades, reliance of government debt on banks' purchasing**
- **Real economy and final corporate clients are hit by inflation, disruptions and volatility in energy prices a situation that reminds us on the hit suffered during the Covid crisis early 2020**
- **Large amounts of liquidity are sterilized as all financial actors increase liquidity buffers due to higher volatility : banks, MMFs, CCPs etc**
- **In the particular case of the CCPs, where 85% of Variation Margins consist of cash, the larger margin requirements operate a transfer of liquidity from unsecured to secured markets and amplify the need for collateral**

GOING FORWARD IN UNCHARTERED ENVIRONMENT : WHAT RISKS DO WE FACE ? 2/2

- OTHER ISSUES THAT MAY IMPACT THE TRANSMISSION OF ECB RATE POLICY
 - The change in Fiscal situation of European States may be a key element in case of large variations of the stimulus. The impact of budget deficits may require different neutral rates than otherwise anticipated
 - EUR/USD FX downward trend



Figures as of end 2019