

ECB MMCG

SEPTEMBER 2021

ECB STRATEGIC REVIEW Introduction to the discussion

CORPORATE & INSTITUTIONAL BANKING
GLOBAL MARKETS



BNP PARIBAS

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CHANGES BROUGHT BY THE STRATEGY

REVIEW

Communication happened in 2 steps

➤ **Strategic Review (July 8th)**

- ❑ **Inflation target:** higher (2%) and formally symmetric (negative and positive deviations from target equally undesirable)
- ❑ **Inflation measurement:** Recommendation to include owner-occupied housing over time
- ❑ **Inflation outcomes:** Tolerance of overshooting (transitory period of inflation moderately above target)
- ❑ **Climate Change** related measures (impact on monetary policy to be expected in 2023)

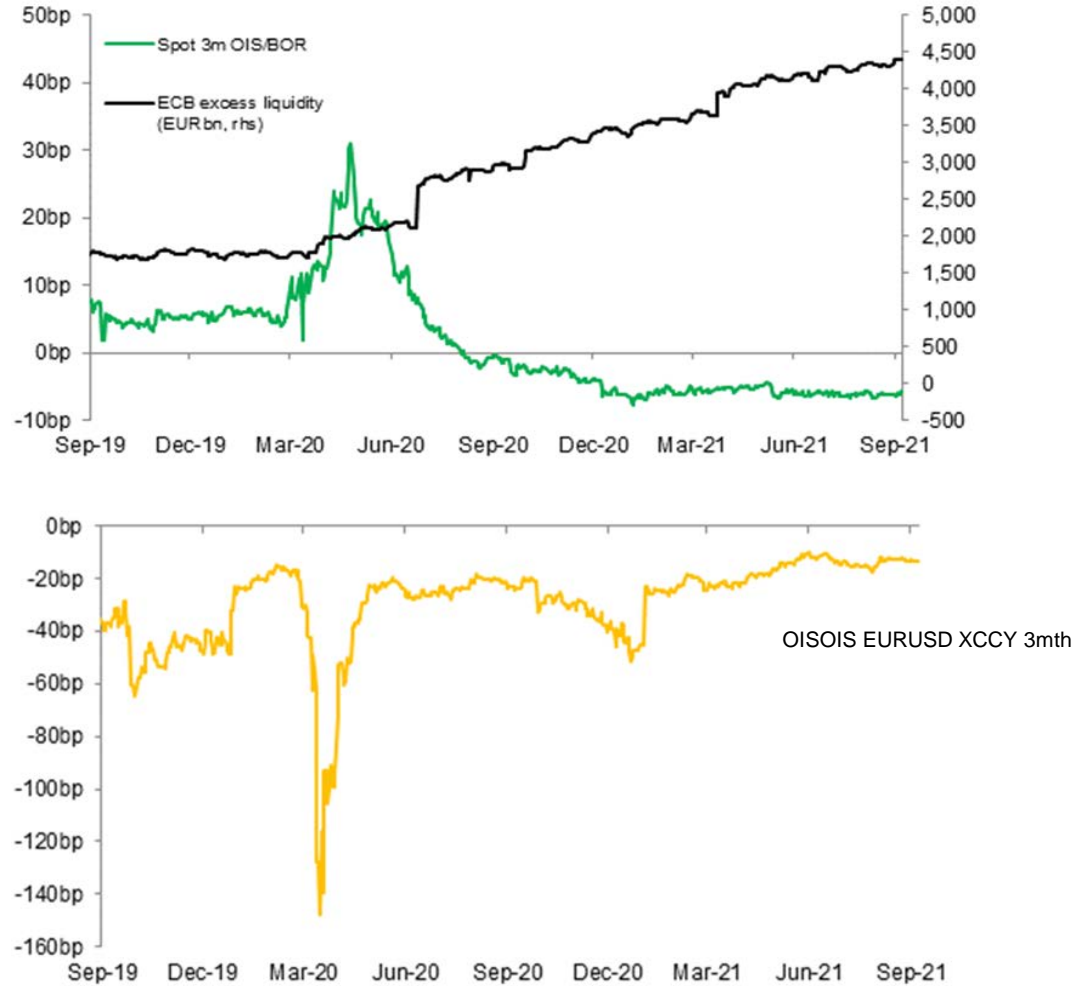
➤ **ECB meeting (July 22nd) Forward Guidance on rates**

- ❑ “Governing Council expects the key ECB interest rates to remain at their present or lower levels until we
 - ❑ see *inflation reaching two per cent well ahead of the end of our projection horizon and durably for the rest of the projection horizon,*
 - ❑ judge that *realized progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilizing at two per cent over the medium term.*
 - ❑ This may also imply a transitory period in which inflation is moderately above target.”
- ❑ “We expect rates lift-off not until mid 2024.”



LIQUIDITY SPREADS

No impact seen on spot levels of OIS BOR and XCCY



Source BNPP, ECB



MONEY MARKET CURVE PRICING

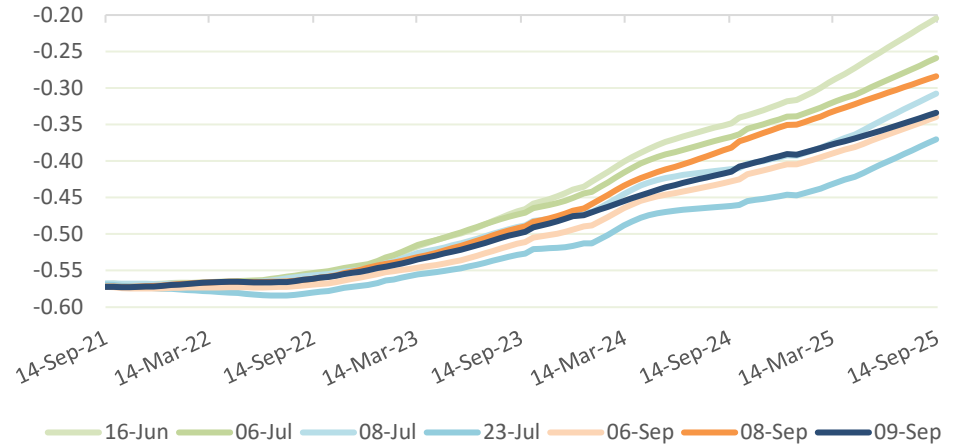
Rate expectations

- Money market curve was pricing ~35bp cumulated hikes by Sep 2025 at FOMC time
 - ❑ Expectations started going down after FOMC
- After the strategic review, 2025 forwards went down 5 bp
 - ❑ And then 7 bp lower after July 22 ECB meeting
- Less dovish comments (ex. BDF) end of August led the market higher into last week ECB meeting
- Market went back lower on ECB meeting day

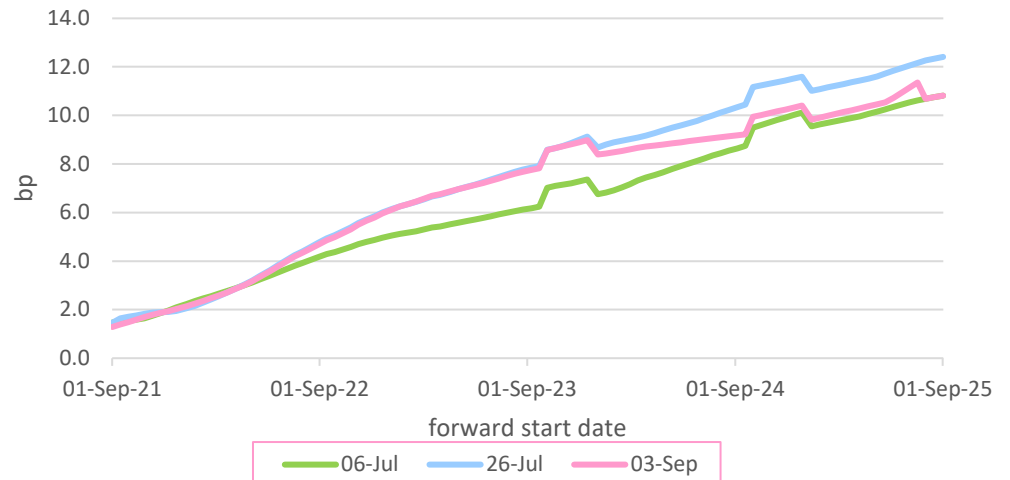
Expected 1mth liquidity prices

- ECB announcements didn't have a real impact on the way market is anticipating the liquidity withdrawal to normalise OIS BOR spreads
 - ❑ Example of 1mth €STR/ 1mth EURIBOR forward spread curves

3mth €STR Forward curves



ESTR vs 1mth EURIBOR forward spreads



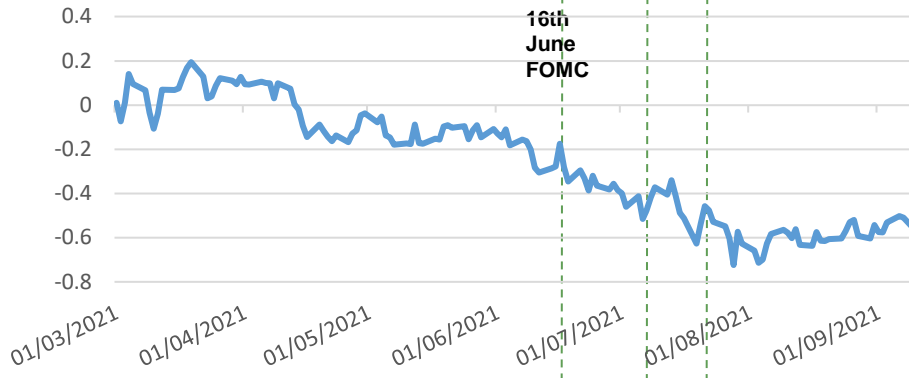
Source BNPP



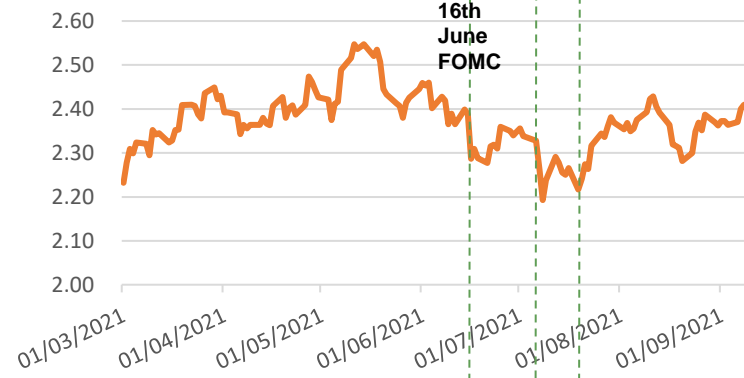
EUR INFLATION BREAK EVENTS AND REAL YIELDS

➤ ECB impact or FED impact?

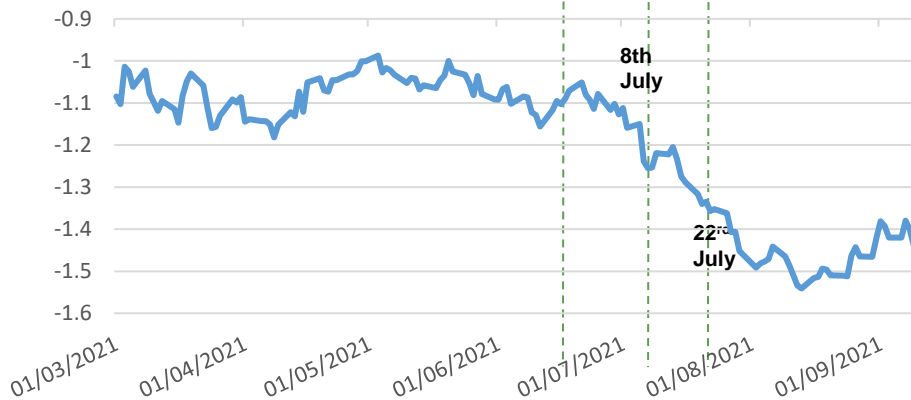
US 5y5y RY



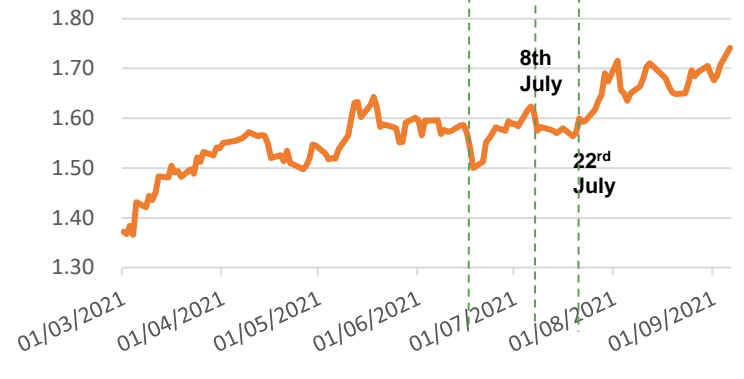
US 5y5y Inf BE



EU 5y5y RY



EU 5y5y Inf BE



- There was no impact of Policy review (July 8th) on B-E, but there was one when ECB clarified its message at the Press conference (July 22nd)
- RY were in a downward trajectory since the June FOMC

- To be noted EUR 5y5y BE is breaking recent range and can now test 2017 1.80% high
- EUR 5y5y RY is still lower than 2019, and 2020 lows of ~-1.39% at -1.44% while US 5y5y RY being -0.5% is ~60 bp higher than 2020 low at -1.10%

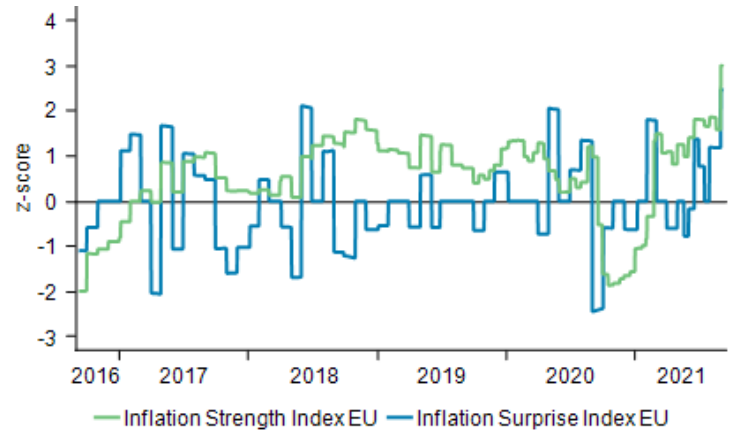
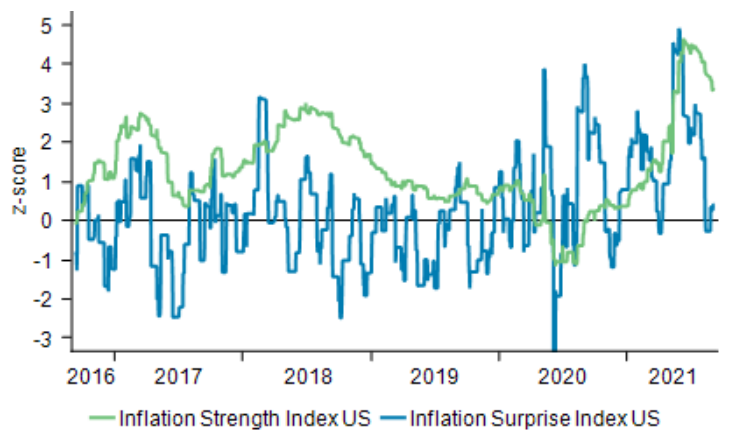
Source Bloomberg, BNPP



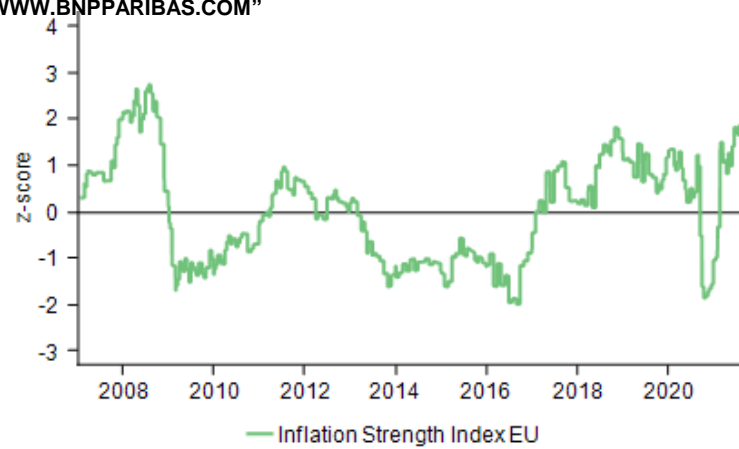
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INFLATION STRENGTH MEASURES



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Inflation Surprise Index:

Construction: We compare data releases against the median consensus expectations from Bloomberg.

Interpretation: Above (below) zero represents that data surprises are generally positive (negative). The index tends to mean revert over a one to two month horizon as expectations can change rapidly.

Inflation Strength Index:

Construction: We compare data releases against their seven-year moving average, with seven years being the approximate length of the business cycle. The rationale being that this average represents the long[1]term pace of the data free of business cycle fluctuations.

Interpretation: Above zero, therefore, represents that the data corresponds to above average inflation. The series take several years to swing from its peak to trough, in line with the business cycle.

Source BNPP



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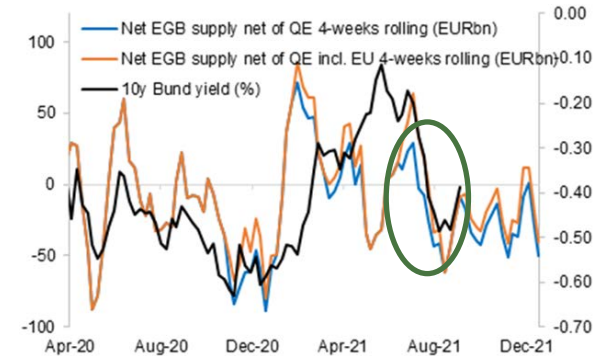
TENTATIVE CONCLUSION

- Difficult to disentangle the different effects which impacted market pricing
 - ❑ General central bank dovishness
 - FOMC dovishness
 - ECB policy review and summer dovishness
 - Aggressive ECB buying amid lower summer issuance
 - ❑ Negative economic surprises: Covid surge, slower perceived growth in China
 - ❑ Global supply chain constraints lowering growth and pushing inflation higher

- A clear sign of success of ECB policy adjustment: 5y5y Real Yield at -1.43%*
 - Below 2020 lows
 - Close to widest level against US equivalent measure

- Recent adjustment to slightly less dovish with RY at record lows

- What is next?
 - ❑ EUR 5y5y inflation swap break even is very close to its 5yr range top (1.80%).
 - A break of that level would mean ECB is succeeding in moving inflation expectations higher
 - ❑ Expectations for ECB meeting were largely skewed towards some form of tapering with rising rates into the event
 - ❑ ECB statement on programs was close to Economists consensus, rates went lower and bonds over-performed on profit taking and maybe for some, disappointing economic projection revisions
 - On PEPP: ECB now plans to buy at “a moderately lower pace than during the previous two quarters” (consensus 60-70bn a month vs 80bn recently)
 - Opening the door on issuer limits?
 - December meeting a “rendez-vous” for PEPP, APP and TLTROs
 - ❑ Will ECB smooth the PEPP March deadline using APP?
 - ❑ ECB will have EU countries draft budgets soon / wage negotiations news?
 - ❑ Announcement on TLTRO will come in December, i.e 1 day after supposedly last operation?



Before ECB meeting

Eurozone (% y/y)	2021			2022			2023		
	BNPP	BBG	ECB	BNPP	BBG	ECB	BNPP	BBG	ECB
GDP	5.0	4.8	4.6	5.2	4.4	4.7	2.3	2.1	2.1
HICP	2.4	2.0	1.9	2.1	1.5	1.5	1.7	1.5	1.4

New ECB projections

Eurozone (% y/y)	2021			2022			2023		
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ANNEX



BNPP VIEW: above consensus on growth and inflation

Fig. 1: Eurozone forecasts compared

Before ECB meeting

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Note: ECB forecasts are from June-21. Bloomberg consensus as of 07/09/21.

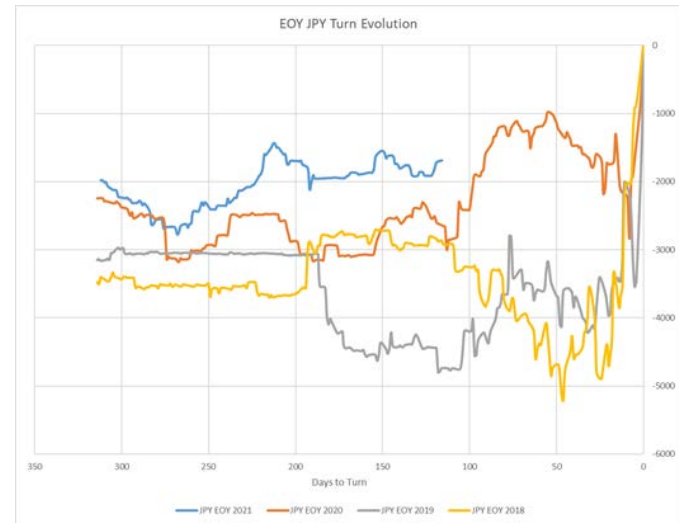
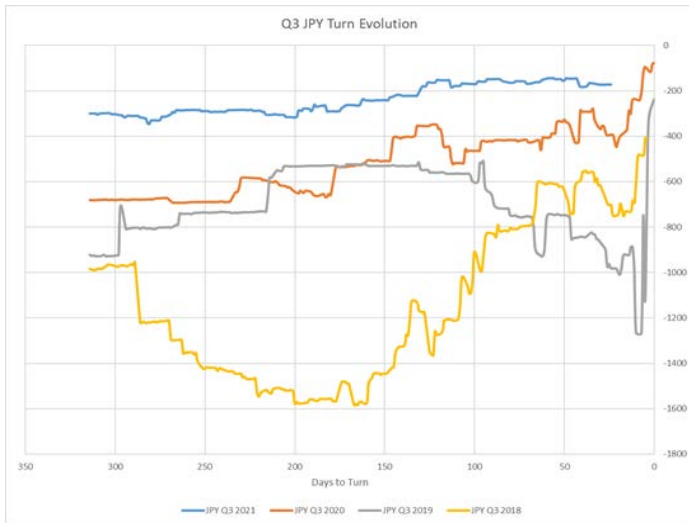
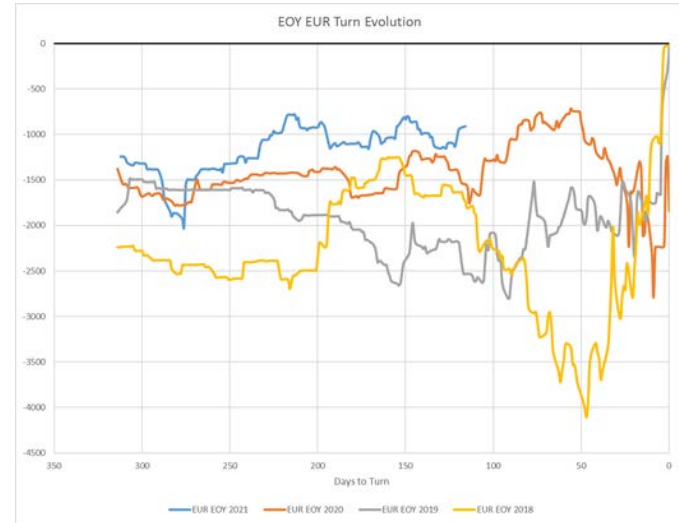
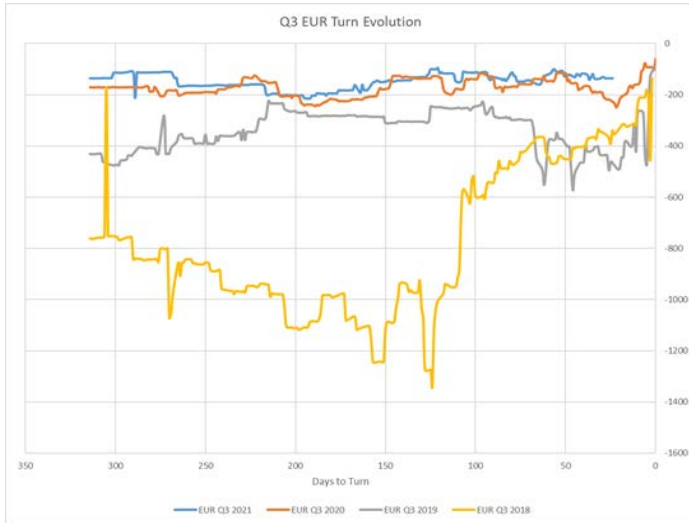
Sources: Bloomberg, ECB, BNP Paribas

- Eurozone still in solid recovery: While, in the short term, supply constraints are likely to hit output to a greater extent than we thought previously (particularly in Germany), we ultimately expect these losses to be recovered, albeit gradually.
- Our view is underpinned by continued substantial support from both fiscal and monetary policy, large household excess savings and hence low vulnerabilities from leverage.
- While we expect inflation to moderate next year, our forecasts remain above consensus, suggesting a sustainable rise towards 2% much sooner than the ECB currently expects.

Source BNPP, ECB, Bloomberg



XCCY MARKET



Source BNPP



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