Money market rates: key trends as balance-sheet normalization goes on

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Summary of economic views

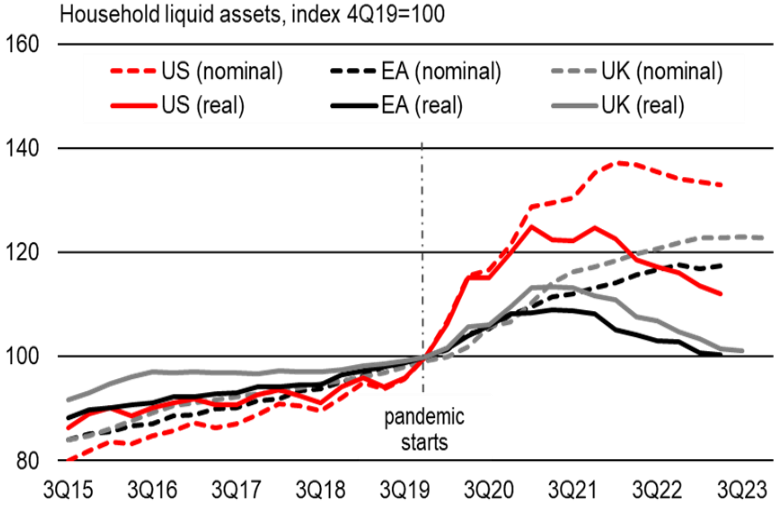
- We forecast **ongoing weakness in global growth in 2024** as monetary policy works its way through the economy. China will continue to struggle. **Disinflation remains well on track**. Headline inflation in the US and the eurozone heads towards 2% and will fall below target in 2025.

- **The Fed and the ECB will start cutting rates in mid-2024** and keep going throughout 2025. Accordingly, we expect curve **bull steepening**. **10Y yields** should end 2024 at around current levels (10Y UST 4.15%, 10Y Bund at 2.40%, 10Y EUR swap 2.80%).

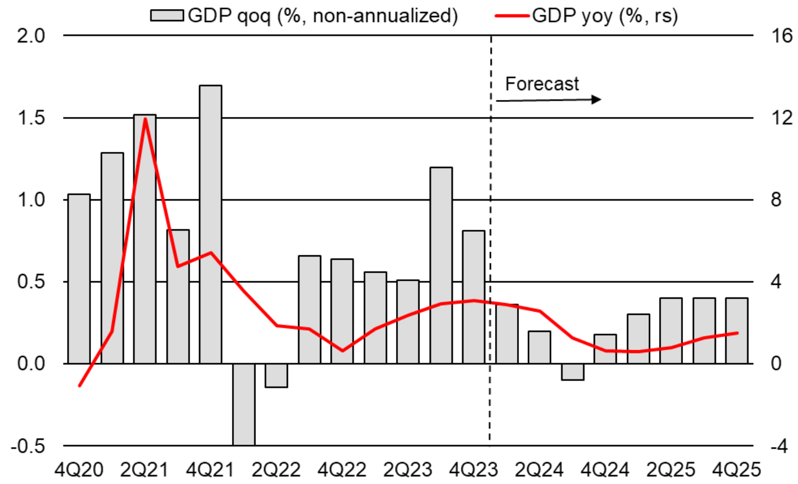
- **Bund/swap spreads are closer to fair value** amid lower collateral scarcity and lower yield volatility. **The belly should underperform** the wings at 2Y and 10Y and the **10/30Y** should steepen.

Source: UniCredit Research

Growth to remain weak as support from savings buffers wanes

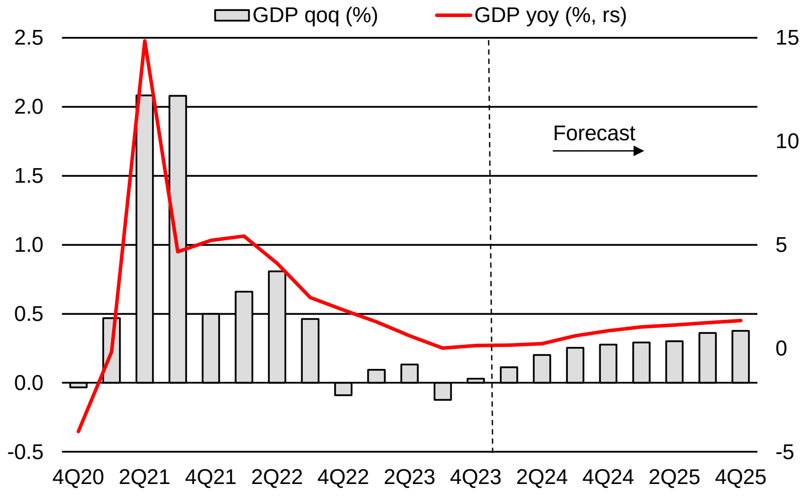


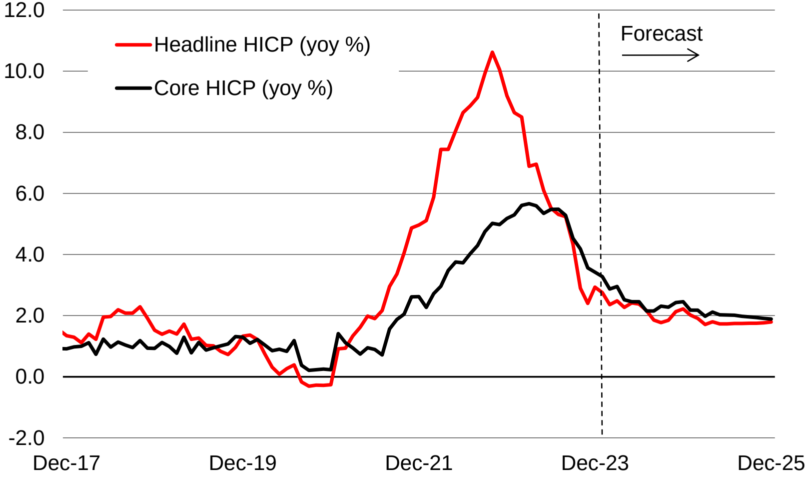
Note: liquid assets are the sum of currency; checkable, time, and savings deposits; and US money market funds. The real series is the nominal series deflated by the all-item consumer price index.



Source: Bloomberg, UniCredit Research

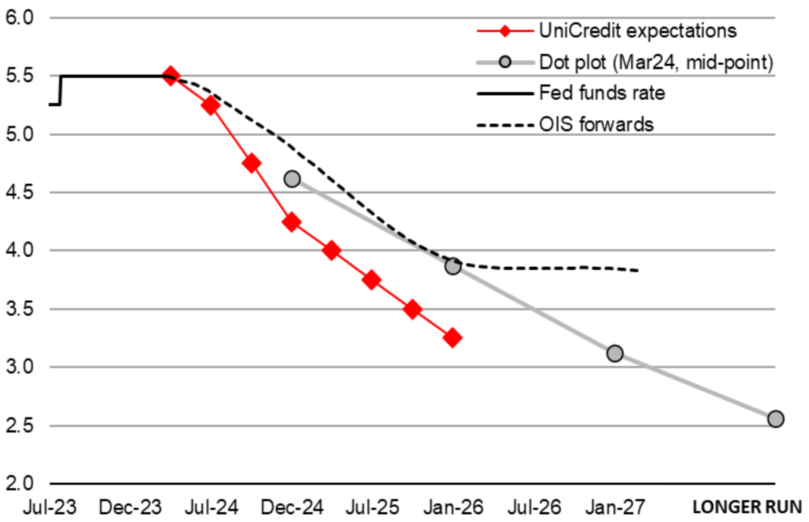
Price stability in sight and soft growth paves the way for ECB cuts

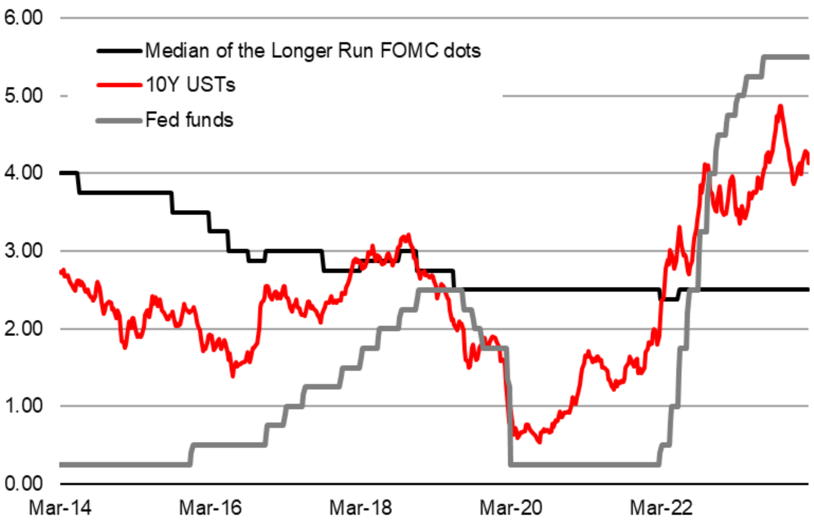




Source: Bloomberg, UniCredit Research

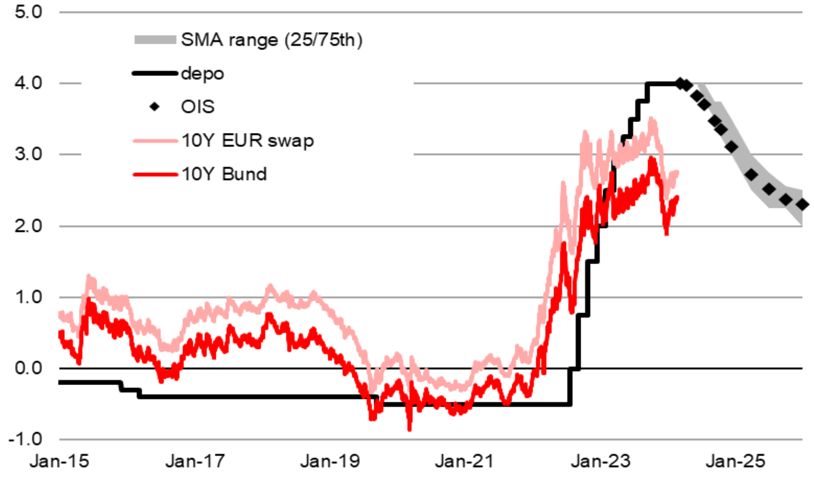
Fed: rate cuts are coming

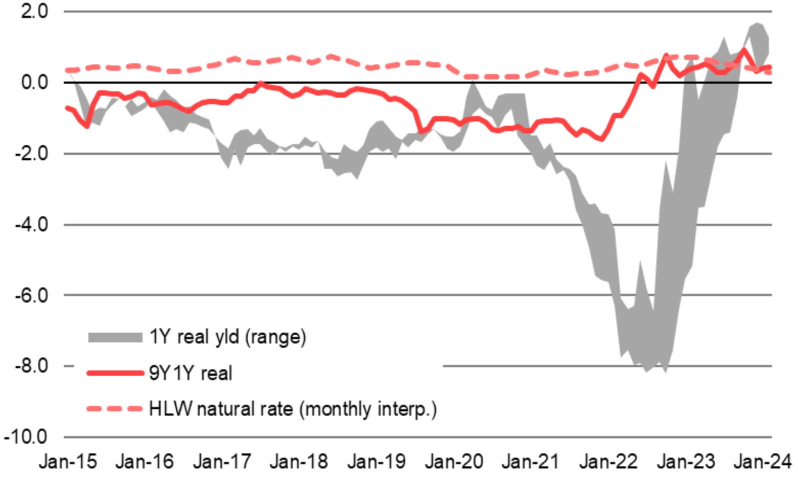




Source: Bloomberg, UniCredit Research

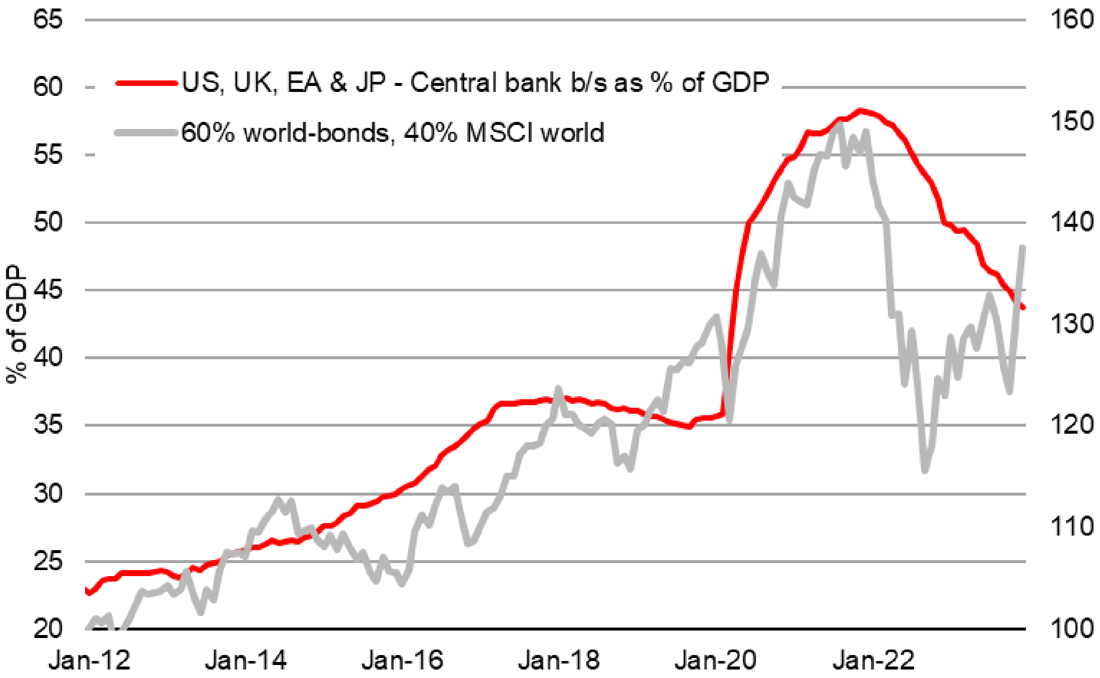
10Y Bund yields: low risk premium or bold easing expectations?





Source: Bloomberg, ECB, UniCredit Research

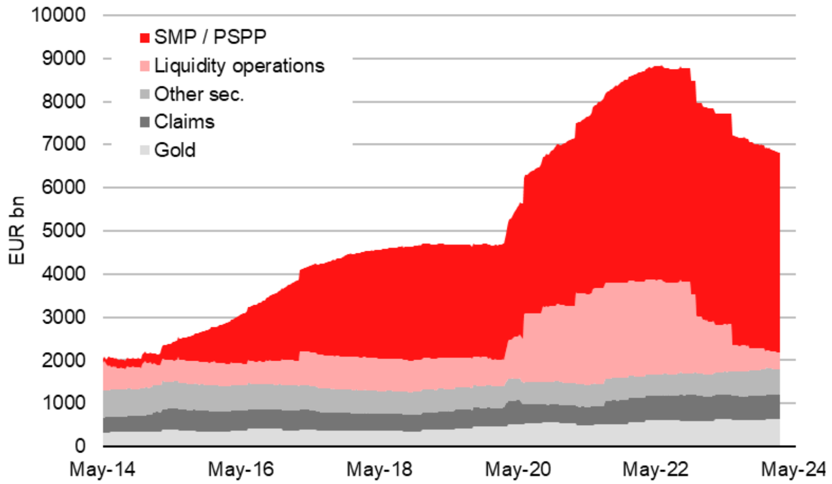
Central bank balance/sheet: the normalization is ongoing



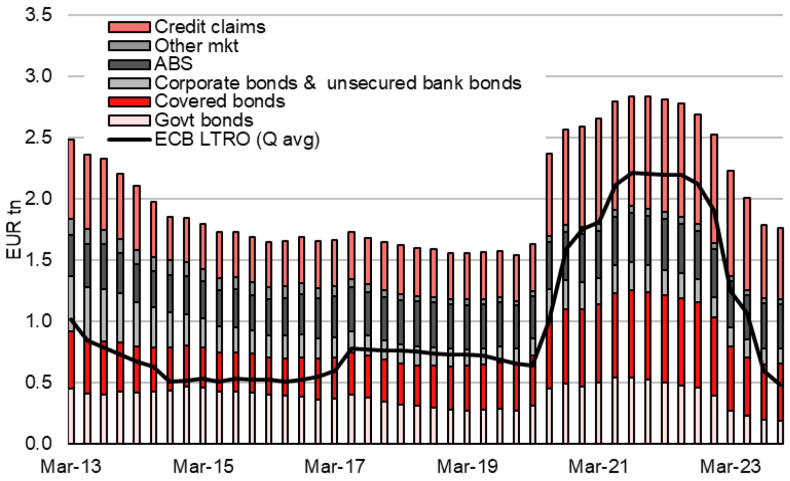
Source: Bloomberg, UniCredit Research

ECB balance sheet normalization in detail

ECB balance sheet



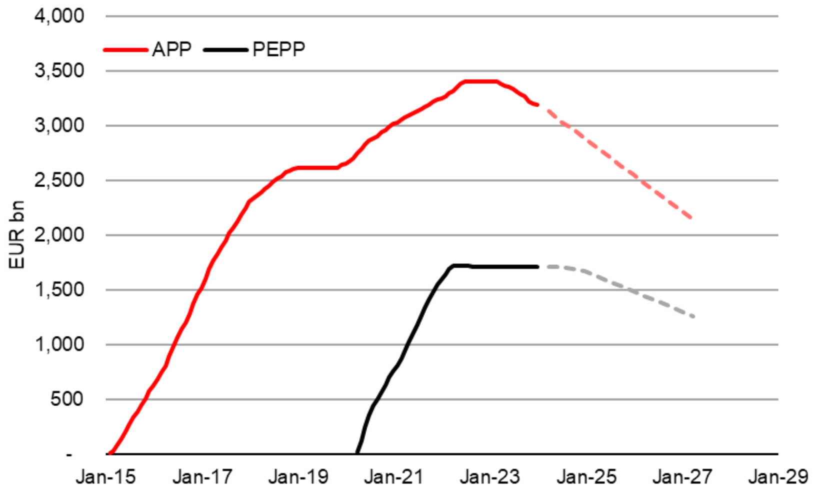
Collateral deposited against refinancing operations



Source: Bloomberg, ECB, UniCredit Research

ECB QT on autopilot, higher disinvestments in 2024 and 2025

Expectations form the SMA survey (January)



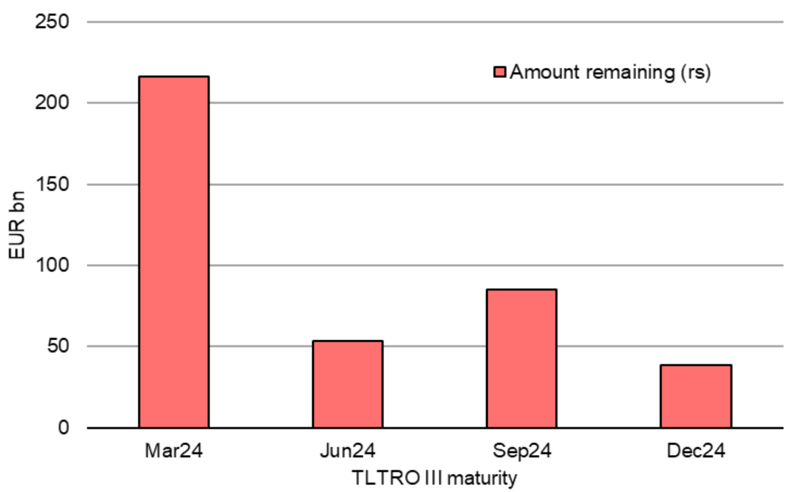
	Implemented since Mar23			2024E			2025E		
	APP	PEPP	Total	APP	PEPP	Total	APP	PEPP	Total
ABS	-8	0	-8	-6	0	-6	-9	0	-9
Cov bonds	-23	0	-23	-32	0	-32	-60	0	-60
Corp bonds	-24	1	-24	-31	0	-31	-38	0	-38
PSPP	-214	-1	-214	-264	-45	-309	-317	-180	-497
Total	-269	0	-269	-334	-45	-379	-424	-180	-604
DE	-66	-5	-70	-63	-11	-73	-75	-43	-118
FR	-37	1	-36	-52	-8	-60	-63	-33	-95
NL	-3	-1	-4	-13	-2	-15	-15	-9	-24
AT	-6	-1	-7	-7	-1	-9	-9	-5	-14
IT	-40	-3	-42	-42	-8	-50	-51	-31	-82
ES	-16	-1	-18	-31	-5	-36	-37	-21	-58
PT	-5	-2	-6	-5	-1	-6	-6	-4	-10
Sovereign	-189	-10	-199	-236	-40	-277	-236	-40	-277
Supras	-24	10	-15	-28	-4	-32	-28	-4	-32

- Redemptions under the APP during 2024 will be EUR 335bn (EUR 265bn in PSPP). PEPP disinvestments are expected to be EUR 45bn (almost entirely in PSPP)
- Consensus from the ECB SMA (from March 24) expects ca. 330bn in QT also in 2025 and in 2026. PEPP disinvestments in 2025 are expected to be EUR 180bn, strongly up from EUR 45bn in 2024. Respondents expect PEPP roll-off to continue also in 2026 at EUR 180bn.

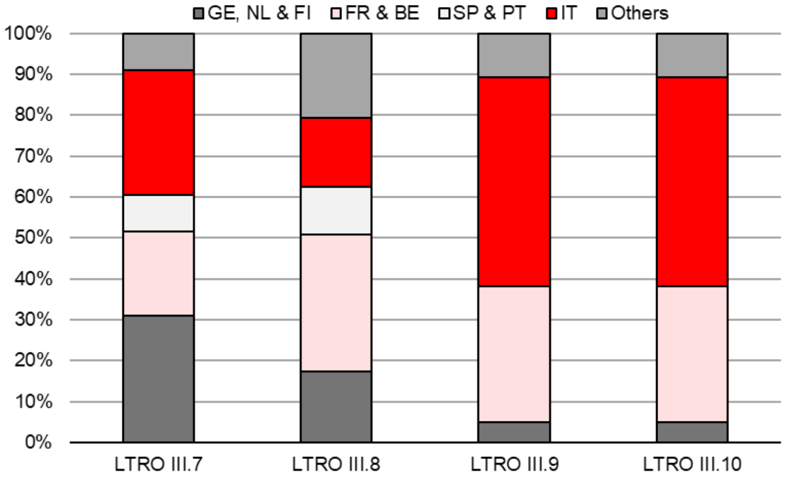
Source: Bloomberg, ECB, UniCredit Research

TLTRO repayment is going smoothly

Remaining TLTRO operations



TLTROs: estimated breakdown by jurisdiction



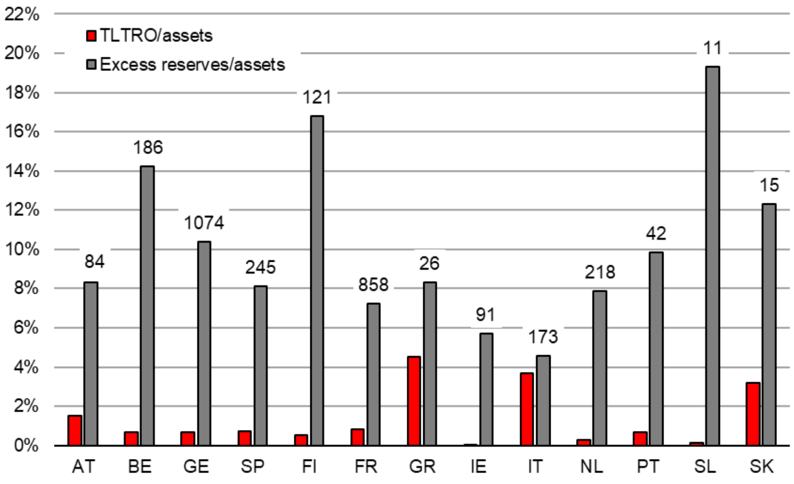
Estimated share of TLTRO by jurisdiction

- Next TLTRO redemption is in March, EUR 215bn, of which Italian banks probably own EUR 60-70bn. Early repayments for the remaining TLTROs amount to EUR 36bn of TLTRO.
- TLTRO repayment should pose no pressure on banks to reduce their bond portfolios. Excess reserves is higher than TLTRO funding across jurisdictions

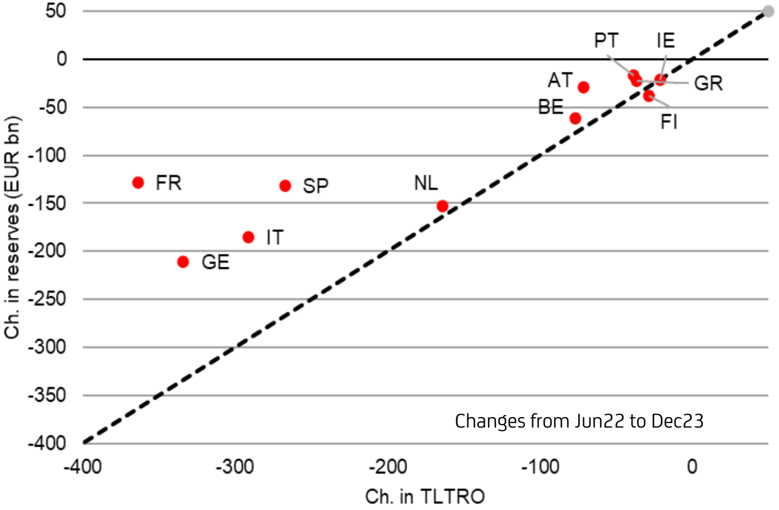
Source: Bank of Italy, ECB, UniCredit Research

Banks have enough excess reserves to repay TLTRO

Excess reserves exceeds TLTROs across jurisdictions



Excess reserves have fallen less than TLTROs as banks have adjusted their b/s

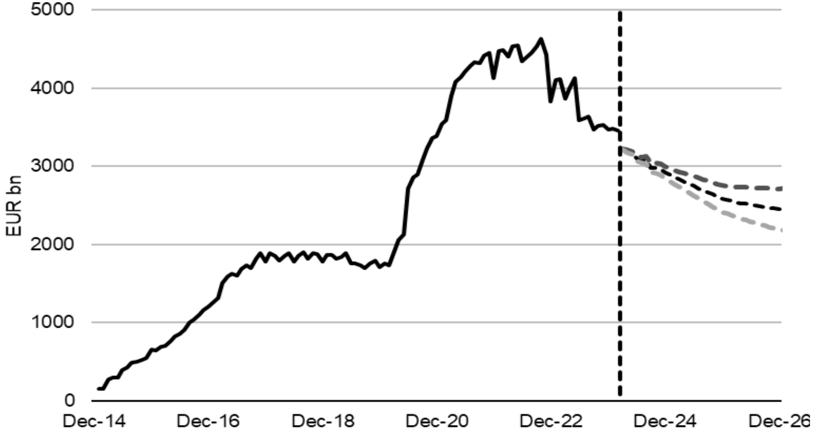


- Excess reserve is still very abundant across jurisdictions, including Italy. As of January 2024, Italian banks hold EUR 57bn in excess reserves in aggregate.
- Since June 2022, banks in the largest countries have adjusted their b/s while repaying TLTRO funding. This is reflected in a lower decline of excess reserves compared to TLTROs

Source: ECB, UniCredit Research

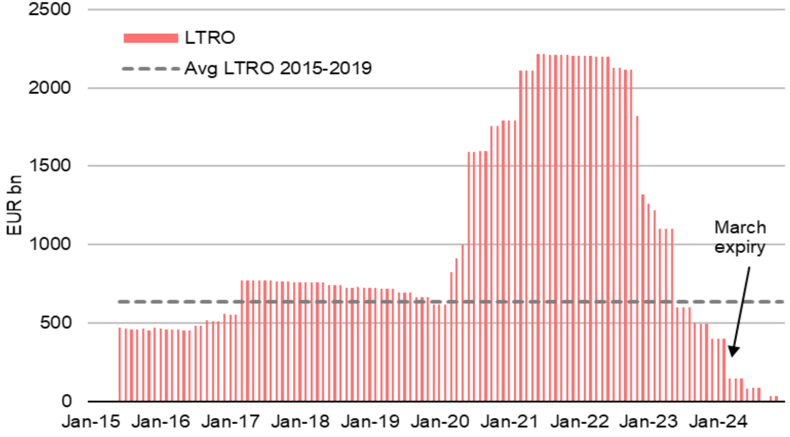
Excess liquidity: we expect a slow decline

Excess liquidity - projections



Baseline scenario assumes that AF decline at 50% of the average of the period Jan22-Dec23 and all TLTRO expire

TLTRO refinancing is heading towards zero

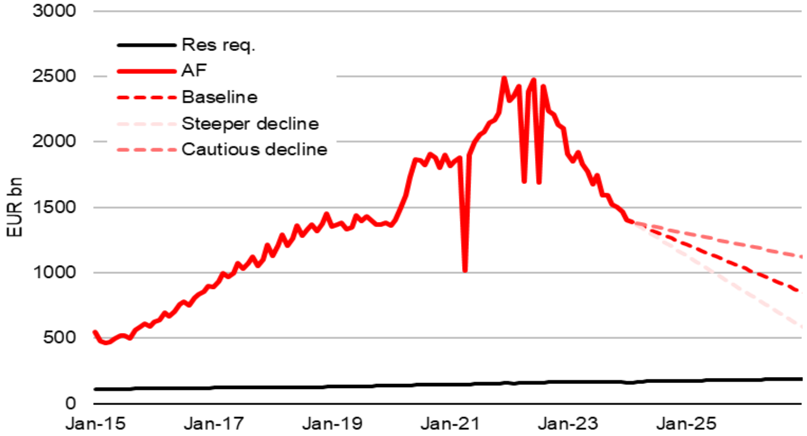


- Excess liquidity in the euro area amounts to EUR 3.5tn as of March. TLTRO redemptions until YE will amount to ca. EUR 425bn. The asset of securities is expected to decline by EUR 290bn. This will push excess liquidity lower – the exact amount will depend on the autonomous factors.
- An open question is also the amount of ECB liquidity that banks will use once the new framework comes into force.

Source: ECB, UniCredit Research

Excess liquidity: autonomous factors play a key role

Autonomous factors



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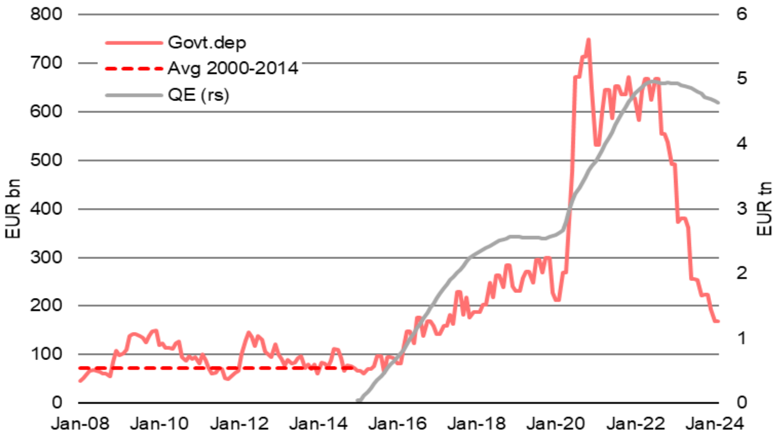
Government deposits: no large room to decline further

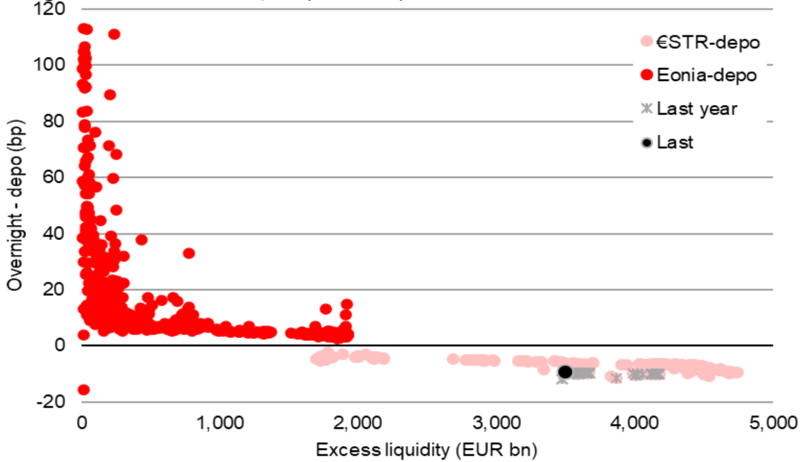


- Autonomous factors have been declining since the start of QT and have in part offset its impact on excess liquidity
- One factor driving autonomous factors down is the amount of government deposits. The ECB decision to remunerate government deposits at a penalizing rate (€STR-20bp) has put incentive on DMOs to mobilize their liquidity

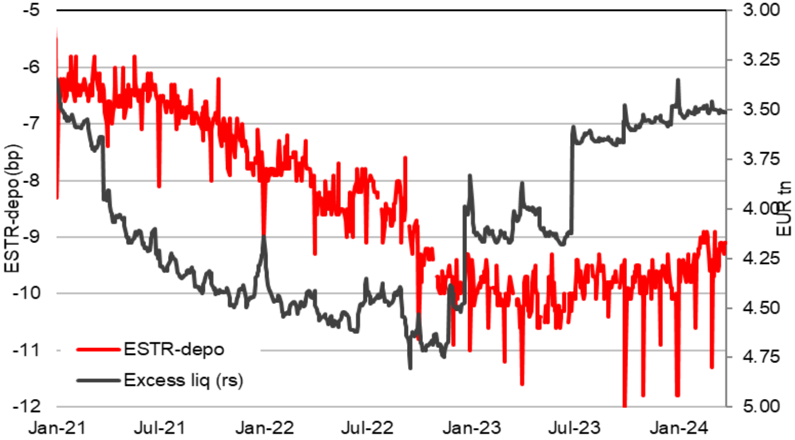
Source: ECB, UniCredit Research

€STR still un-elastic to shrinking excess liquidity

Overnight rate versus excess liquidity: elasticity ...



...and recent developments

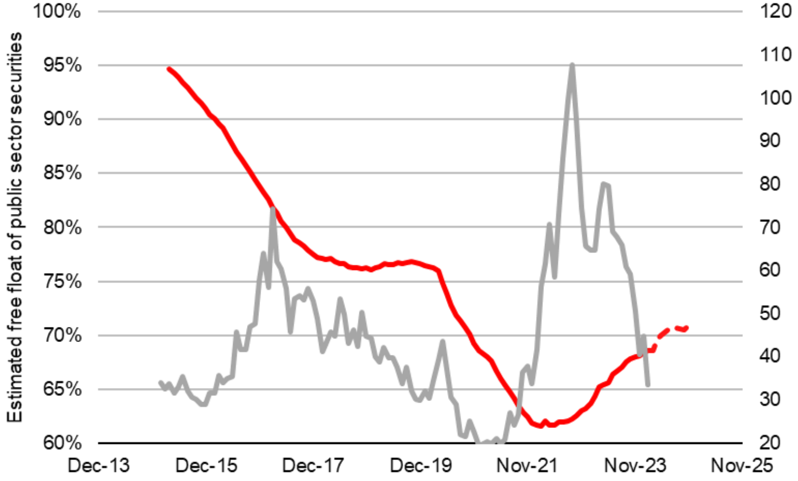


- €STR has not been affected much by the reduction in excess liquidity and we do not expect much pressure going forward as we expect excess liquidity to remain above EUR 3tn during most of this year
- Key issue is if banks' demand for excess reserves has changed after the recent shocks (COVID, supply chain shocks etc)

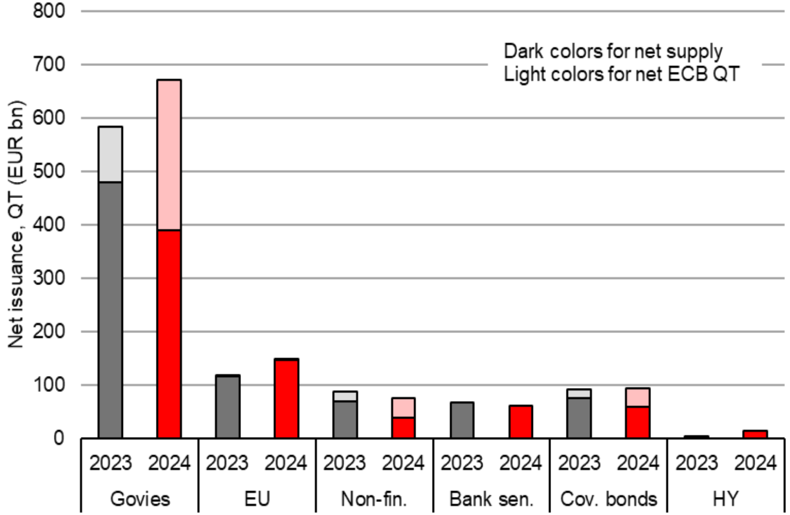
Source: ECB, UniCredit Research

Bund scarcity is easing

Bund/swap and collateral scarcity



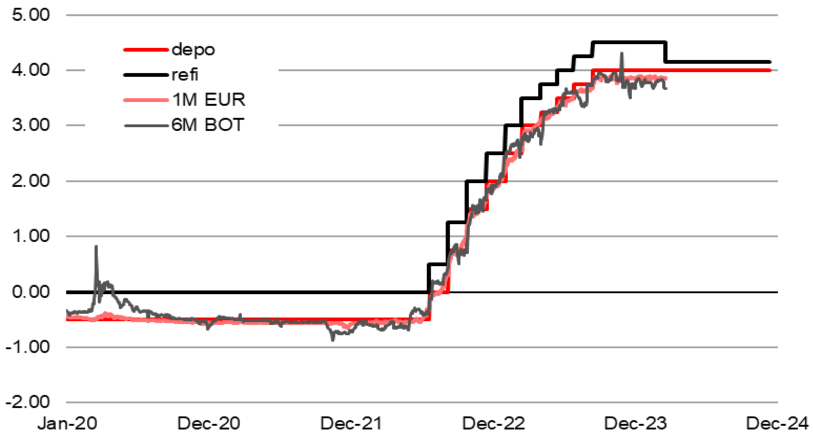
Supply in 2024 expected to remain intense

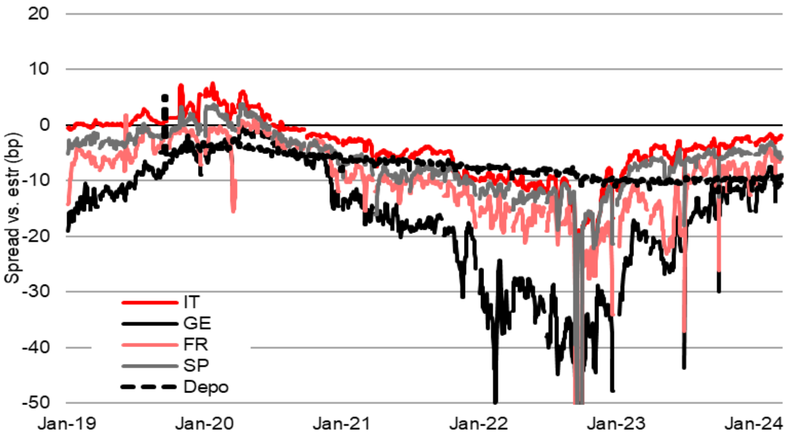


- Lower collateral scarcity has supported cheapening of Bund/swap spreads, which are now close to fair value. In 2024, we expect the ECB to disinvest EUR 75bn in Bunds while net supply from Finanzagentur should amount to EUR 40bn (EUR 80bn is we focus on M/L term bond issuance).
- At the end of 2023, banks were depositing EUR 190bn in public sector collateral. We expect part of this sum to be unlocked with upcoming TLTRO repayments. Key question is how much will be used again once the new ECB framework comes into force

Source: ECB, UniCredit Research

The new ECB framework should cap short term rates

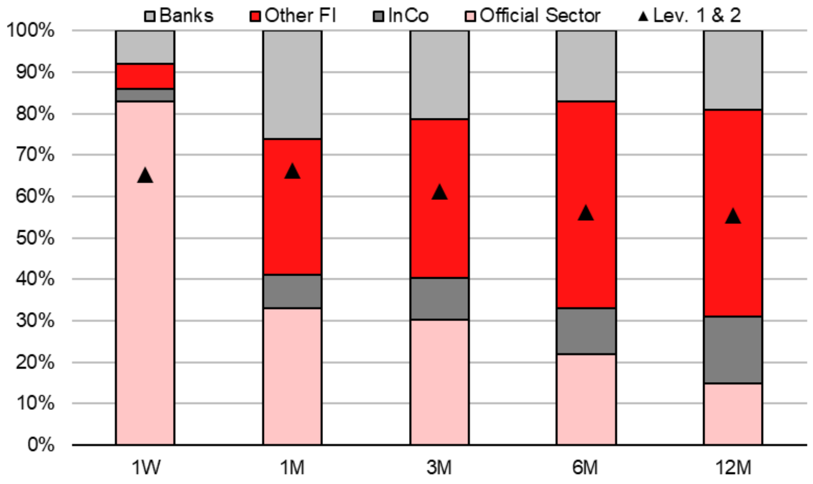


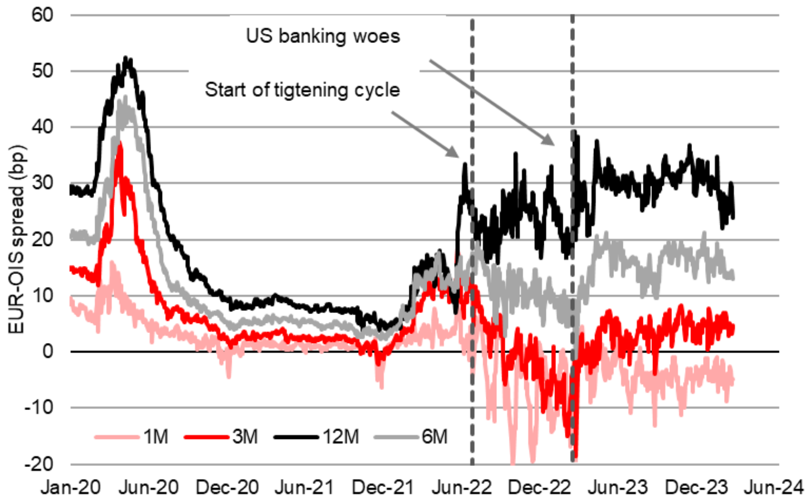


- Tight corridor should reduce stigma and support demand for liquidity by banks
- Repo rates to be capped at depo+15bp (approx. €str+25bp)
- Longer tenor operations to be launched at a later stage

Source: ECB, UniCredit Research

Euribor-OIS: negative 1M reflects liquidity parking





- Short-maturity Euribor rates trade through the ECB depo. This is likely due to high presence of public sector transactions, especially with respect to the 1-week tenor
- 3M EUR-OIS likely close to f/v, also in light of new ECB framework

Source: ECB, UniCredit Research

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