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EXPECTATIONS FOR THE ECB POLICY OUTLOOK

Money Market Contact Group – European Central Bank

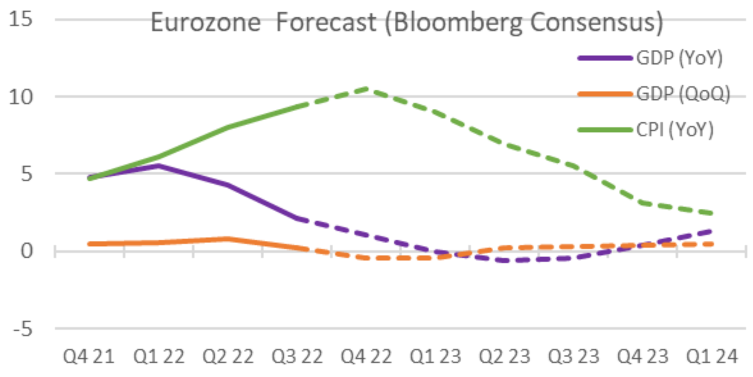
December 7th, 2022

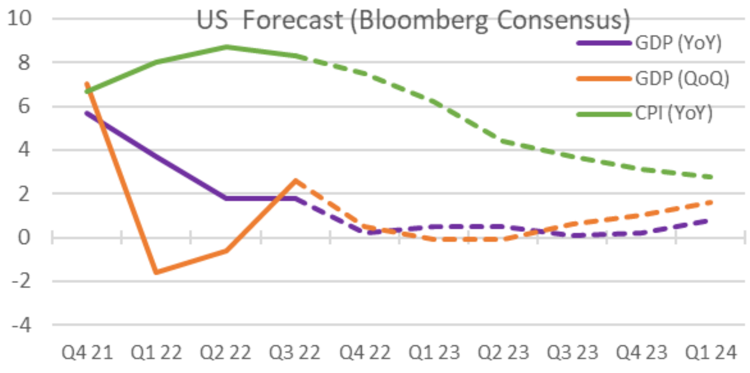
Treasury and Collateral Management | Group BPCE/Natixis

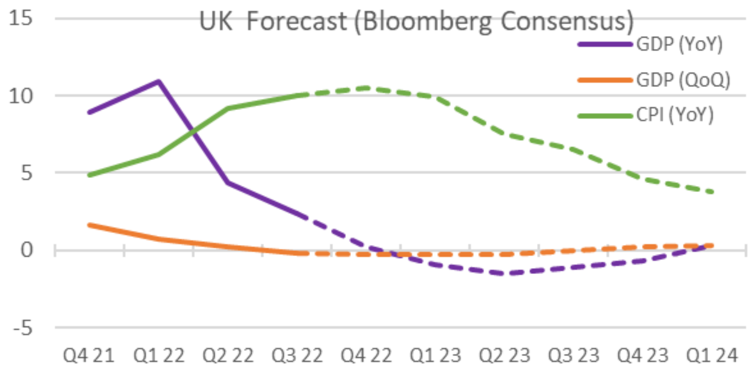
GROUPE BPCE

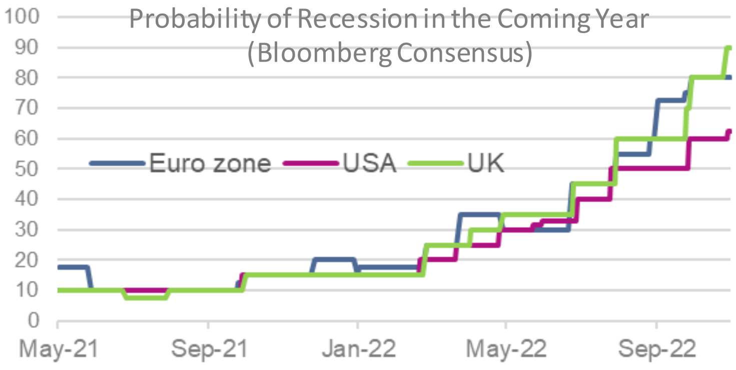
CONFIDENTIAL

1 Economic Outlook









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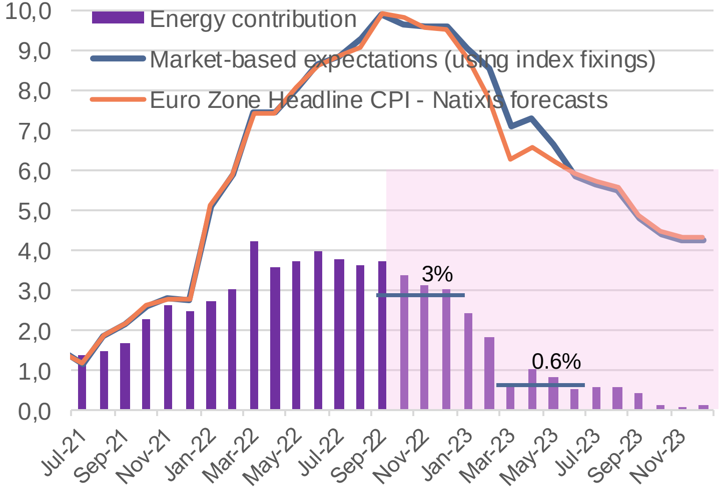
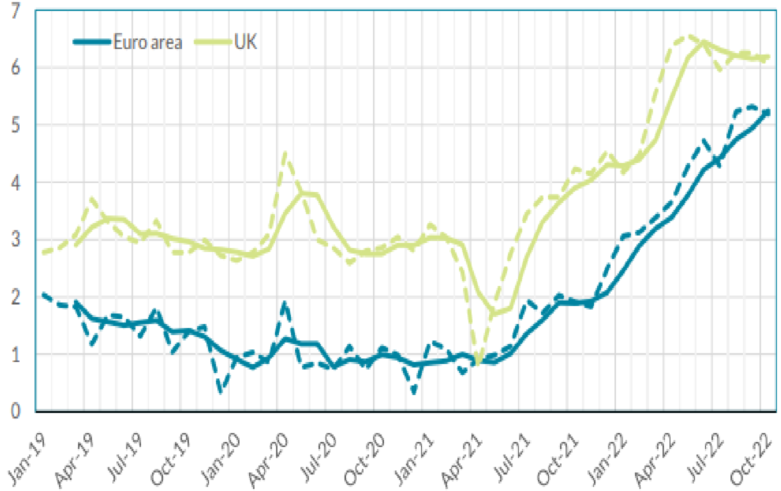
2 Economic Outlook

- Inflation peak seen in October 22 (10,6%) and EZ CPI should really start dropping by March 2023 when positive basis effect due to energy prices will start disappearing (based on weaker energy prices ahead and continuation of EU states support).
- Risks to scenario : Geopolitical + cold winter + more wages adjustments and wage-price spiral.



Nominal year-on-year wage growth in job postings (%)
(Central Bank of Ireland Economic Letter - 2022 n°7)



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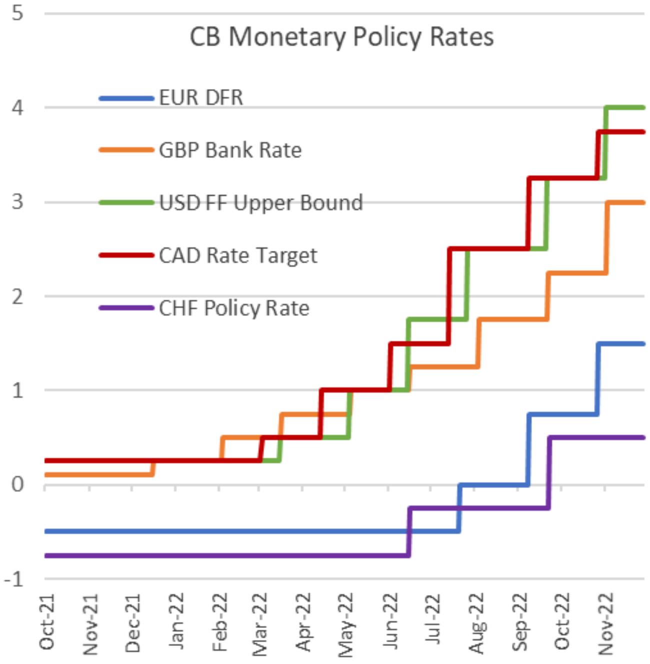
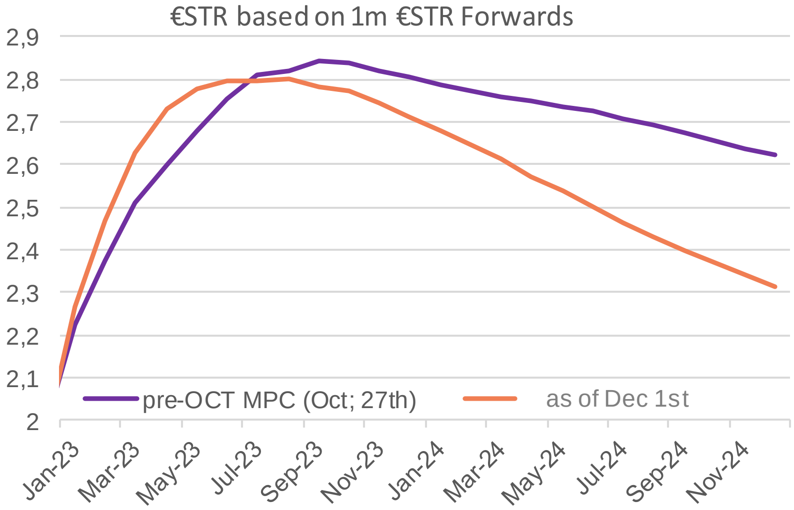
3 Central Banks Reaction

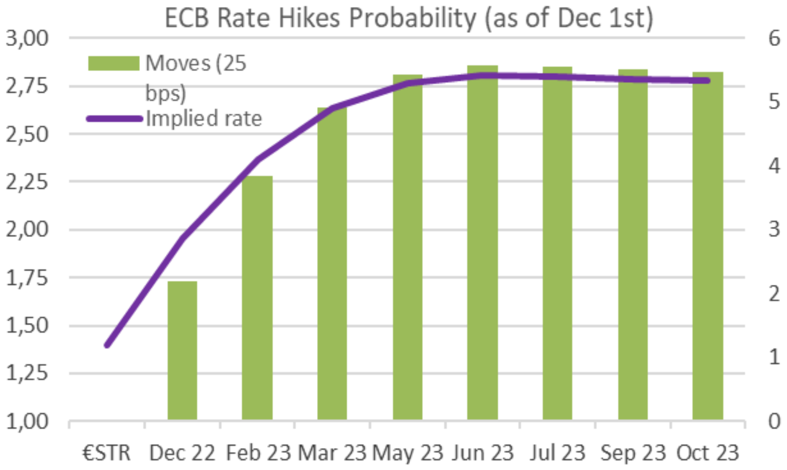


- European Central Bank
  - +200 bps
  - QT : **?**
- US Federal Reserve
  - +375 bps
  - QT : ≈ - 400 bn$ in 2022, -1,1 Trn$ in 2023
- Bank of England
  - +290 bps
  - QT : -80 bn£ in 2023 (-9,5% of current holdings)
- Swiss National Bank
  - +125 bps
  - Foreign Reserves Management
- Bank of Canada
  - +350 bps
  - No reinvestments (-31bn,-7,5% from July to October)

4 Monetary Policy Rates Forecast

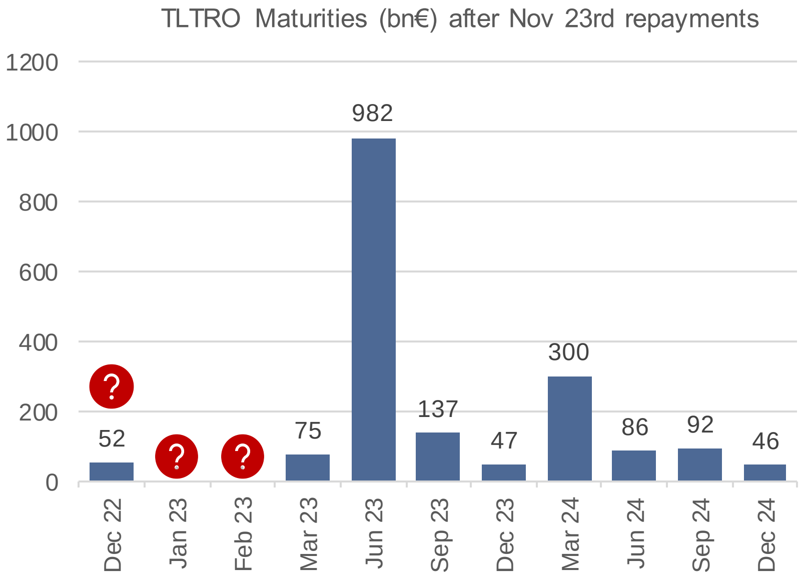
- Terminal rate expectations have been very volatile.
- December hike forecast softened after the lower than expected US CPI and lower energy prices.
- P. Lane said another steep increase of 75 bps was not a given at the ECB Governing Council meeting on December 15 (market pricing : 55 bps as of Dec 1st).
- The market expects another 140/150 bps hike before end of S1 2023 (DFR ≈ 3%).
- Natixis forecast : +50 bps in December, +25 bps in February, +25 bps in March, terminal DFR 2,50%.

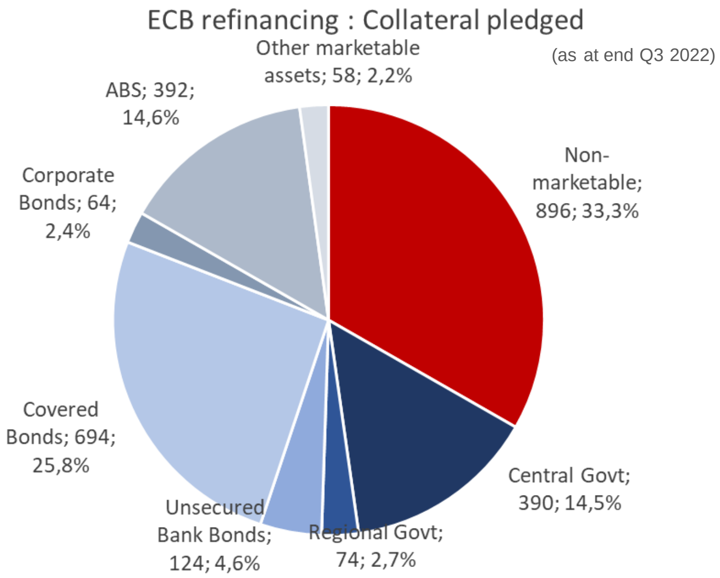




5 TLTROs

- Whatever early repayments are, at least €1,3Trn will mature before end of 2023 and a bit more than €1,8Trn before end of 2024.
- Considering the collateral pledged we can assume that at least 20% of the collateral freed can be refinanced under good conditions.
- Straight liquidity and LCR can be managed through 3 months LTROs.
- Main concern remains NSFR.
- Natixis forecast : €500bn voluntary repayment in December (mainly from TLTRO-III.4 maturing June 2023).





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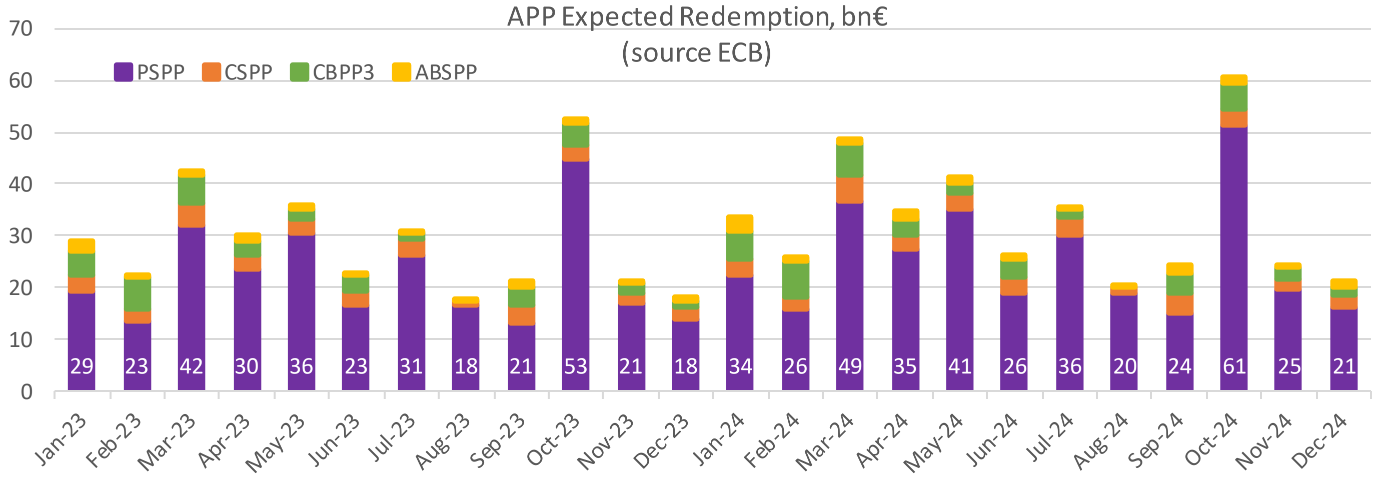
6 Quantitative Tightening

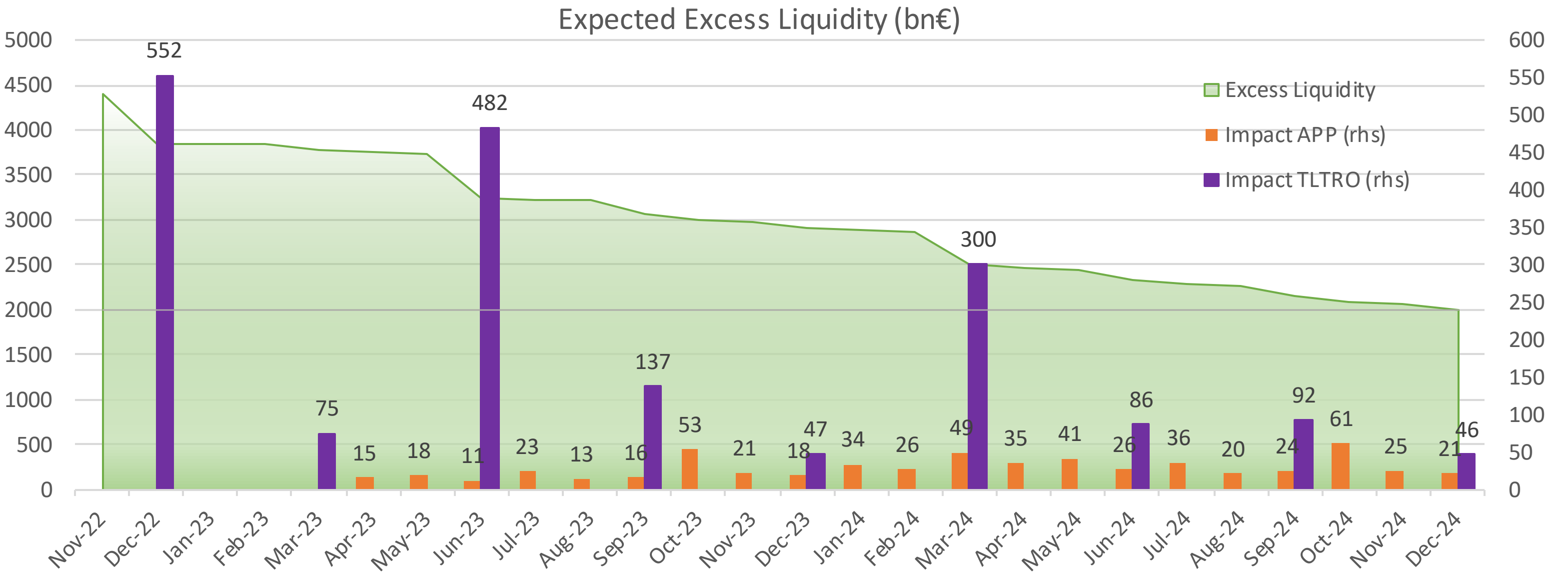
- With the TLTRO repayments, the ECB's balance sheet will be reduced by 24% (from €8.8Trn to €6.7Trn) and around 18% before end of 2023. This is already bigger than what the Fed will be doing via its QT.
- L. de Guindos indicates that ECB should opt for a 'passive approach' and that the process should be 'cautious and prudent'.
- P. Lane advocates a mechanical process to "contribute to the overall stance by essentially reversing the kind of compression of term premia that QE did".
- We expect that the ECB will communicate on a given % of reinvestment in order to have a similar impact on all issuers, starting maybe at 50% of redemptions to be reinvested with a 25% decrease per quarter.
- The start of the QT will depend on how big TLTRO repayments will be : the bigger, the later the QT.
- Natixis forecast : -50% reinvestments from April 2023, -75% from July 2023, end of reinvestments in October 2023.



7 # Liquidity

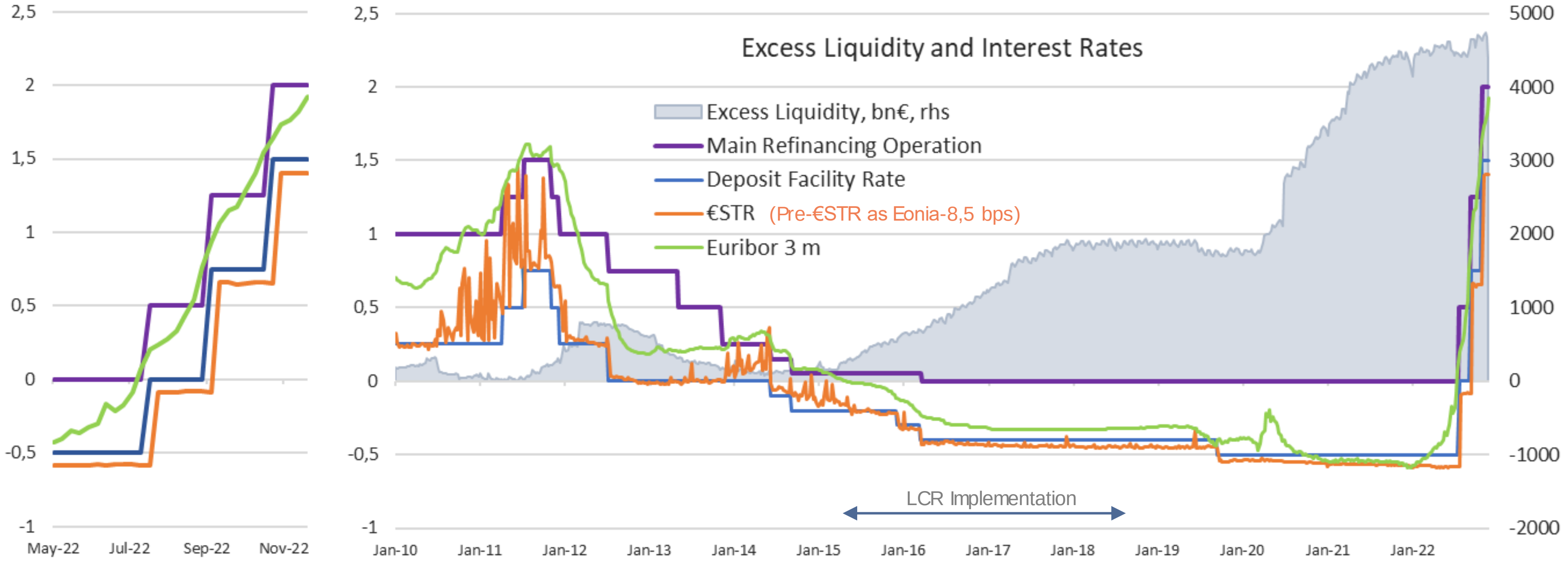
Assumptions :

- €500bn voluntary repayments in December 2022 (from TLTRO-III.4 mat. June 2023)
- PEPP maturities reinvested until end of 2024
- ECB stops reinvesting APP maturities by 50% in April, 75% in October, 100% in October accounting-189 bn in 2023, -397 bn€ in 2024).
- In this scenario, excess liquidity would stand around €2900bn at the end of 2023 and €2000bn at the end of 2024.



8 Liquidity Impact on Rates

- Efficient transmission of monetary policy rates despite huge excess liquidity.
- Since LCR final implementation short term rates are stucked around (or below) the Deposit Facility rate.
- Comfort zone seems to be between €1500 bn and €2000bn excess liquidity.



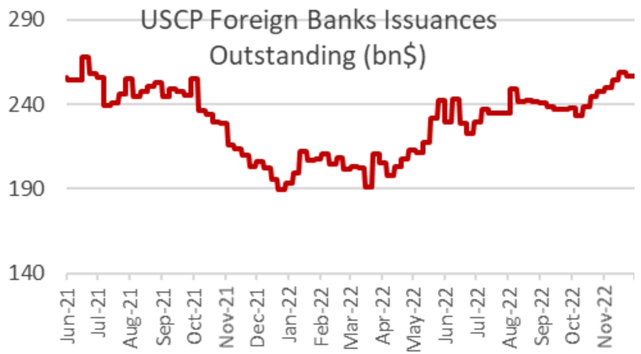
9

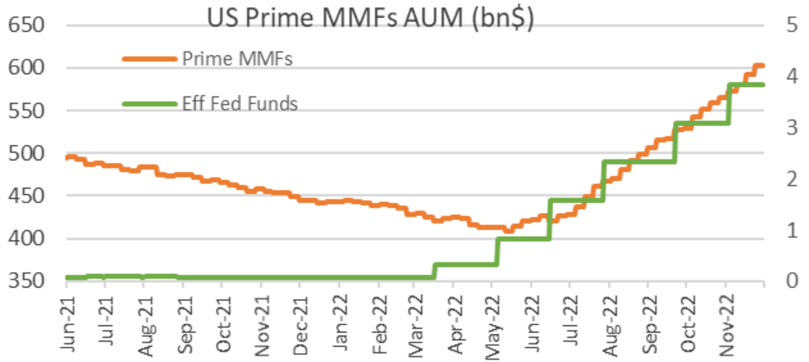
Flows

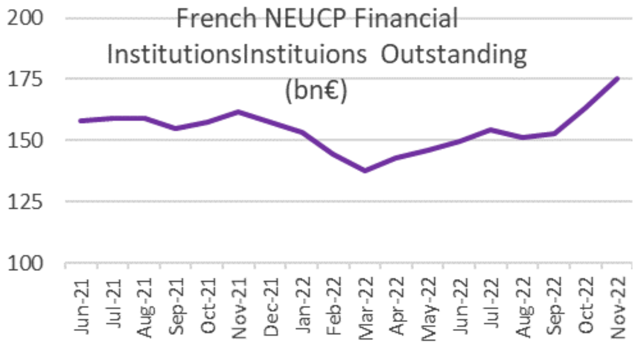
Higher rates triggered a change in cash allocation from corporates and retail to the benefit of Money Market Funds.

After increasing liquidity buffers (Ukraine crisis) investors reopened term investments to enjoy higher credit spreads and rate anticipations.

Private banks are also very active, mainly in USD (own experience : Time deposits x 3 since May 2022),







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