

Fixed Income Special

NORD/LB Markets Strategy & Floor Research

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Face-saving ECB decision: Hawks have won – for now

Authors: Dr Frederik Kunze // Dr Norman Rudschuck, CIIA // Jan-Phillipp Hensing

ECB decision: New cards are now on the table for 2022

At its regular meeting today, the European Central Bank confirmed that it will end net purchases under the Pandemic Emergency Purchase Programme at the end of Q1/2022. At present, it has already been reducing the pace of purchases for some time. In return, as already decided in December, the conventional Asset Purchase Programme (APP) will be increased. However, this has been given a game changer, as the sums are identical to those previously communicated, but the time horizons have been changed from quarterly to monthly. Details are as follows: In April, the APP will initially be doubled to EUR 40bn (previously: entire Q2), in order to reduce this purchasing pace to EUR 30bn already in May (previously: entire Q3). As early as June, the ECB will reduce the APP to the initial level (EUR 20bn per month; previously: entire Q4). Consequently, the ECB is scaling back its purchases – as we postulated in our scenario analyses of recent weeks – even more quickly than we thought possible. There is still no end date for the APP, i.e. the new cards that are now on the table are valid at least until beyond June 2022 well into the second half of the year. An end of the APP in Q3 is currently the most likely scenario, but the ECB now made this data-dependent. The Council also no longer expects net purchases to end very shortly before the start of the increase in key interest rates, but shortly before – quibbling over the timeline. APP reinvestments will continue beyond that point and will be maintained for as long as necessary, thereby maintaining favourable liquidity conditions and extensive monetary policy accommodation.

Key interest rates unchanged as expected

As expected, no key interest rate adjustment was decided today. Accordingly, the interest rates for the main refinancing operations, the marginal lending facility and the deposit facility remain unchanged at 0.00%, 0.25% and -0.50%. The Governing Council also did not reiterate the possibility of lower interest rates.

Charm of maximum flexibility not used, but expected purchase volume under the APP significantly reduced

The ECB has been postulating the greatest possible flexibility for many months. So we asked ourselves recently, why should it flagellate itself, so to speak, with monthly target values? Now, however, it has decided in favour of concrete monthly values. In our view, the PEPP was a charming example: The ECB could have switched to an envelope for the APP, which it would have aimed for as a target value at the end of the purchase program. This could have been EUR 150bn or even EUR 330bn. In addition, this scenario would have included the trump card "flexibility" of acting more accommodative until the summer and then only flanking the market to prepare for an interest rate turnaround. In addition, this would have granted all degrees of freedom to respond to the dynamic war situation between Russia and Ukraine and, if necessary, to carefully vary the accelerator pedal. Thus, purchases under the APP will be significantly reduced overall (approximately halved) compared with the statements made in December and February, which we would call a "hawkish" turnaround, even if Christine Lagarde speaks rather of a continuation of the course.

ECB purchase program: previous path versus new path**Previous path**

- By end of Q1: Discontinuation of PEPP, EUR 1,850bn not exhausted
- Q1 2022: APP is at EUR 20bn per month
- Q2 2022: APP doubles to EUR 40bn per month
- Q3 2022: APP is reduced to EUR 30bn per month
- Q4 2022: APP returns to current level (EUR 20bn per month)
- H1 2023: First interest rate hike by 25 basis points

Total APP 2022: **EUR 330bn**

New path

- By end of Q1: Discontinuation of PEPP, EUR 1,850bn not exhausted
- Q1 2022: APP is EUR 20bn per month
- *April: APP doubles to EUR 40bn*
- *May: APP is reduced to EUR 30bn*
- *June: APP back to EUR 20bn (no end date)*
- *Further reduction in Q3, possibly in steps of EUR 5bn each*
- *Q4 2022: First rate hike by 25 basis points*

Total APP 2022: **EUR 150-180bn**

Source: ECB, NORD/LB Markets Strategy & Floor Research

ECB projections: Inflation revised upward for all years and ...

With a view to the ECB Staff Projections, our focus is once again on the assumptions regarding inflation developments. After all, these expectations serve as a guideline for the monetary policy course in Frankfurt. As expected, they have been revised significantly upward for 2022. For the current year, after only three months, the central bank now expects an inflation rate of - attention - 5.1% (previously: 3.2%), while the ECB projections here are 2.1% for 2023 (previously: 1.8%) and 1.9% for 2024 (previously: 1.8%). The figure for 2025 will be communicated for the first time in December. The ECB is thus painting a clear picture with regard to its own assumptions on future price developments and is assuming a temporary increase in inflation rates. However, Lagarde's assessment at the press conference that inflation is increasingly likely to stabilize at 2% should be emphasized in this context. In June, we expect another upward revision of the projections, as the current oil price development was only partly included in the March forecasts and the duration of the war in Ukraine seems questionable.

... GDP growth now expected to weaken

The ECB sees growth in the euro zone of 3.7% in 2022 (previously: 4.2%). For 2023 and 2024 it expects 2.8% (previously: 2.9%) and 1.6% (previously: 1.6%) respectively. A positive here is clearly that the recovery should be boosted by the waning pandemic. As with the inflation projections, the expectations for the pickup in real economic activity have yet to be assessed or fully taken into account in the light of the war in Ukraine and the economic setbacks beyond that. In this respect, the expected upward revisions in the inflation rate are also accompanied by downside risks to the GDP projections. Higher inflation and lower growth in the past often reflexively stoked fears of stagflation. As we argue below, growth above 2% does not go hand in hand with the definition of stagflation, just as we caution against using words like trotting or even galloping inflation (20-50%) at present.

Portmanteau: Stagnation plus inflation = stagflation

As mentioned above, inflation forecasts are increasing from meeting to meeting and growth prospects are declining, which once again brings the term stagflation into focus. Stagflation is in fact described as the combination of a slowdown in economic growth and a high inflation rate. As a rule, stagflation is also triggered by a supply shock, such as the one we are currently experiencing as a result of Russian President Putin's war of aggression. Historically, the phenomenon of stagflation could be observed in almost all Western economies, especially during the oil crisis in the 1970s. Currently, a strong increase in energy and oil prices can also be observed, favoured among other things by the sanctions of the EU and the USA. On Monday, the price of a barrel of Brent crude temporarily exceeded USD 135, thus also driving up the cost of private car use. However, the high energy costs not only affect private households in the form of heating, travel and electricity costs. Companies also have to bear these same energy costs and consequently have to cope with higher production costs, which entails the risk that production capacities will be reduced. If demand remains the same, this will lead to rising prices. Due to supply chain problems, among other things, production is being slowed down at the current margin (despite full order books). A further increase in inflation expectations would have a reinforcing effect on stagflation, which in turn could promote a wage-price spiral. The ECB, with its primary objective of price stability, would be of crucial importance in the event of impending stagflation. In the current context, the ECB's conflicting objectives with regard to the stagflation issue become obvious: Price stability (and thus rising interest rates in response to inflation) vs. strengthening the economy through a more expansionary monetary policy. Today's press conference therefore also focused on the ECB's new forecasts. It should be noted here, however, as already mentioned, that the forecasts have not yet (fully) taken into account the war of aggression. The figures are therefore still from the "old world", before the turn of the century ushered in by Putin. Today, the Governing Council has clearly decided to fight inflation.

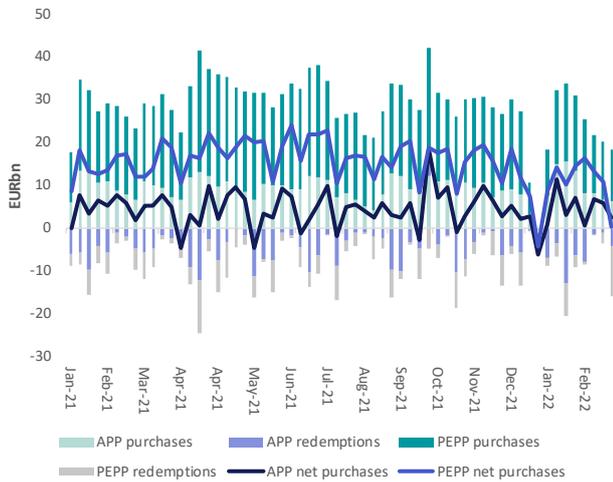
Termination of the PEPP before the end of the pandemic

For months, it has been expected that PEPP net purchases would end at the end of March 2022. As a reminder, the central bank's PEPP dates back to the outbreak of the coronavirus in 2020 and was intended to help avert the negative shock. This pandemic emergency - in purely medical terms - can by no means be regarded as over today. Nevertheless, the situation at the current juncture - in terms of monetary policy - is quite different from what it was in March of 2020. The waves of infection in the winter have made it clear that the dramatic simultaneous supply and demand shock from 2020 has not been recovered globally.

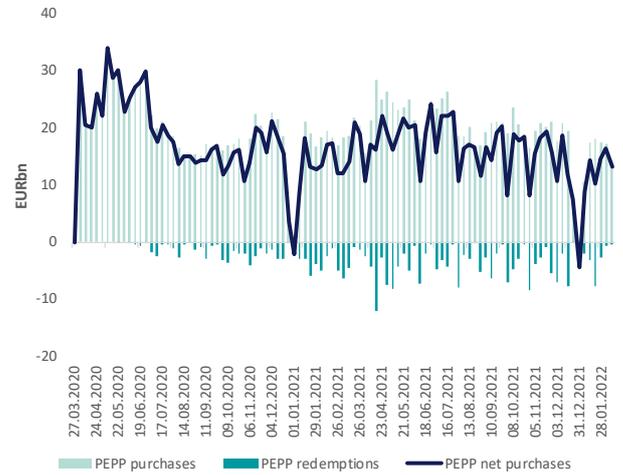
PEPP: Nothing is over until it's really over?

However, with today's communication, we believe the ECB retains the ability to revoke the PEPP end date or revive the program if necessary. This decision as well its communication remains as soft as butter in our view. After all, this could happen, for example, in Q2, Q3 or even Q4. As President Lagarde has pointed out in the past, a PEPP restart would require a Council decision, and the duration would ultimately depend on the circumstances.

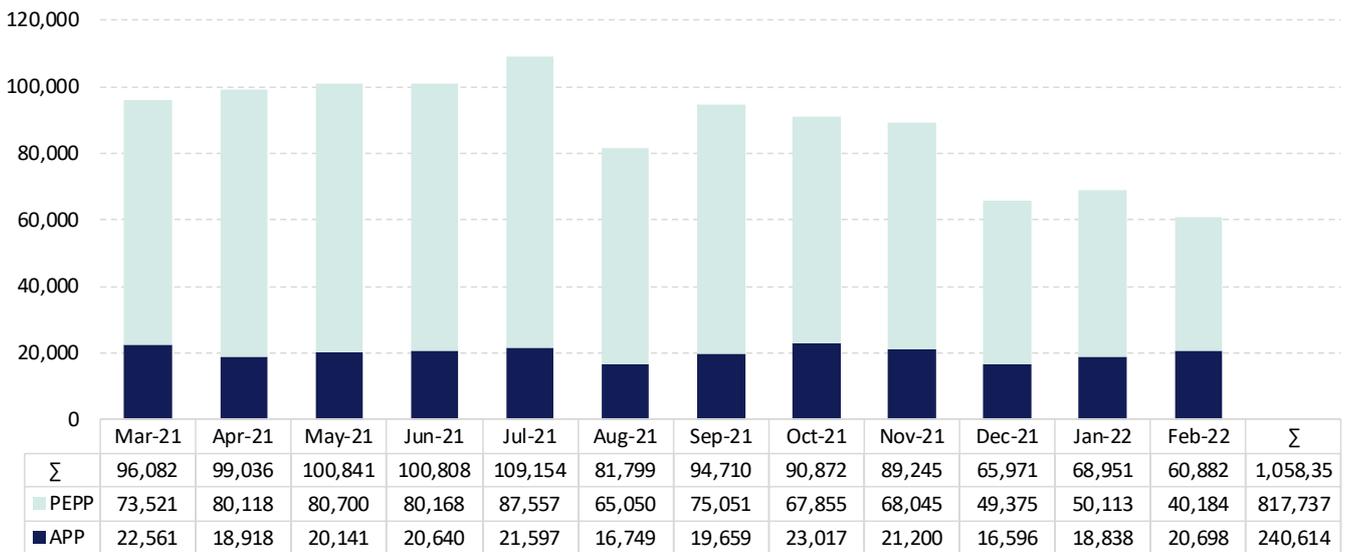
Purchases under the APP and PEPP (2021 ytd)



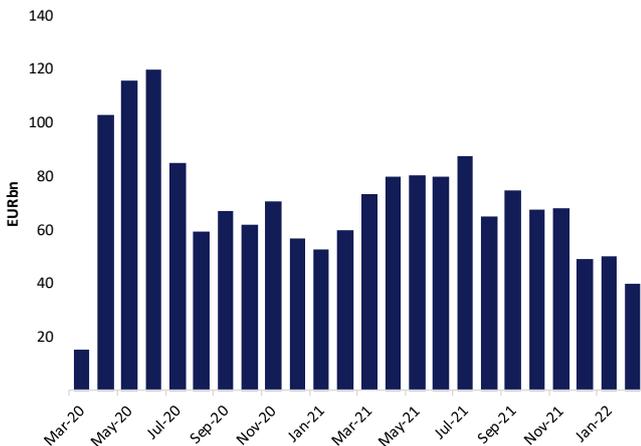
Purchases under the PEPP (since inception)



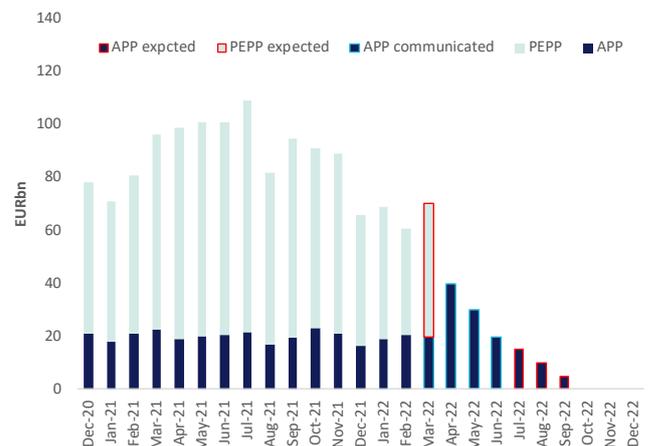
Monthly net purchases (in EURm)



PEPP: Monthly net purchases



APP and PEPP: Monthly net purchases



No newsflow: TLTRO not subject of current discussions

The current discussions in the Governing Council focused less on the TLTRO III tender. In principle, we believe that everything has been said here for the time being. The attractive conditions end in the middle of the year. With regard to TLTRO, we did not expect any concrete decisions in any case and would justify this not least with the current timetable of the current TLTRO III program. A follow-up program, if it appears necessary at all, would not come to the fore until later in the year. In any case, we do not see a TLTRO IV as our baseline scenario.

Conclusion and comment

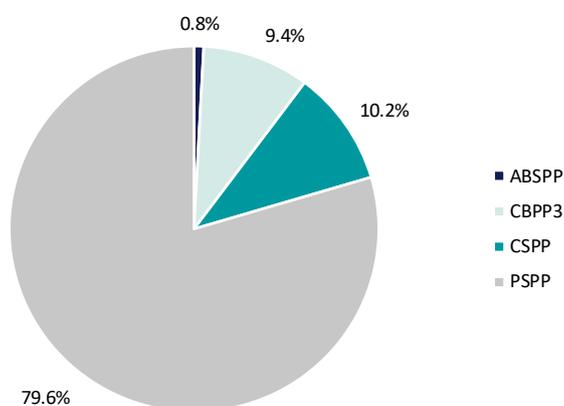
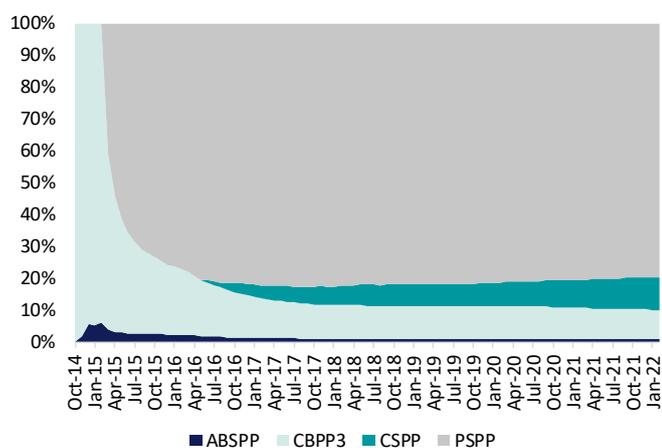
We would sum up today's ECB meeting in one sentence: The hawks are one step ahead and have won – for now! To carry out face-saving a role backwards, may have prepared the ECB today quite fierce internal discussions. The extent to which this truce between hawks and doves could be deceptive will possibly become apparent in the further course of the first half of the year. Formally, it is certainly not a mistake to initiate the monetary policy turnaround. Only the external circumstances are once again proving extremely challenging (inflation plus war of aggression). The ECB wants to chase away the specter of inflation. That is understandable. But will it be traded in for fears of stagflation? Financial market stability also remains an issue, as President Lagarde emphasized in the same breath as price stability. In the future, the question of real economic activity will at least be asked more frequently. Uncertainty remains immense, because neither we nor the ECB have a blueprint on how to deal with the current situation. The current mixed situation cannot be found in any textbook. We expect a first interest rate step in December, although the ECB is flexibly keeping every door verbally open in all directions. We see impulses for spread widening in the universe of asset classes we are looking at. This must be a consequence of lower demand alone. How far the upcoming possible repricing could go also depends on the next trading days. We very much hope for geopolitical relaxation.

ECB tracker

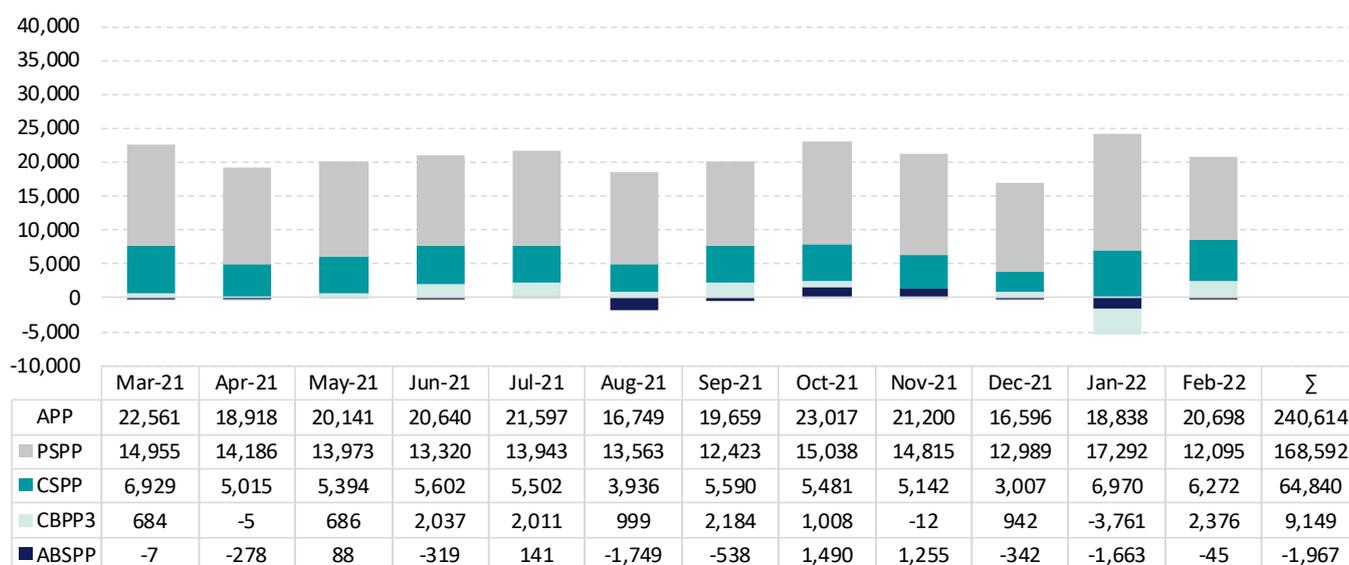
Asset Purchase Programme (APP)

	ABSPP	CBPP3	CSPP	PSPP	APP
Jan-22	26,740	294,407	316,646	2,504,428	3,142,221
Feb-22	26,696	296,783	322,918	2,516,523	3,162,920
Δ	-45	+2,376	+6,272	+12,095	+20,698

Portfolio structure

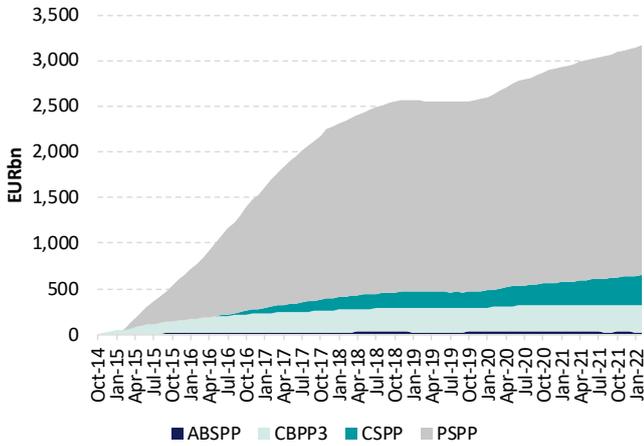


Monthly net purchases (in EURm)

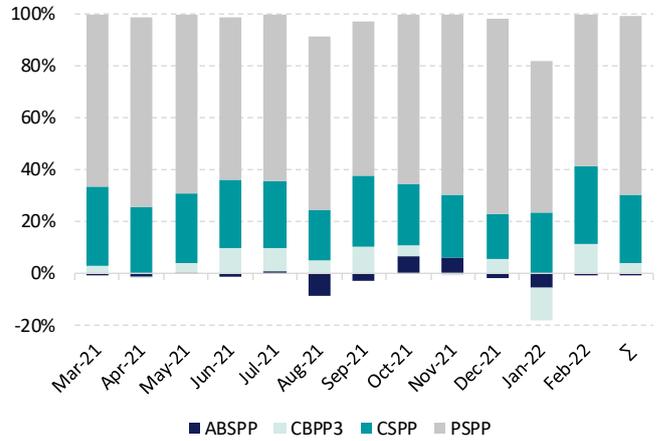


Source: ECB, NORD/LB Markets Strategy & Floor Research

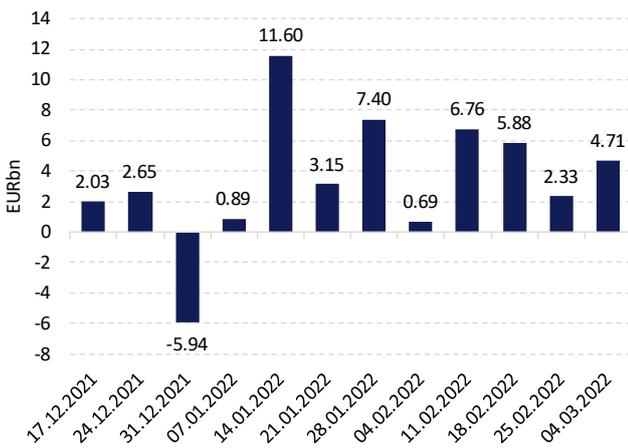
Portfolio development



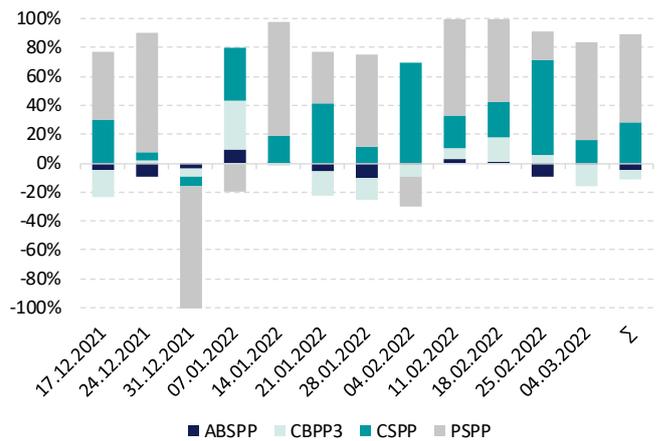
Distribution of monthly purchases



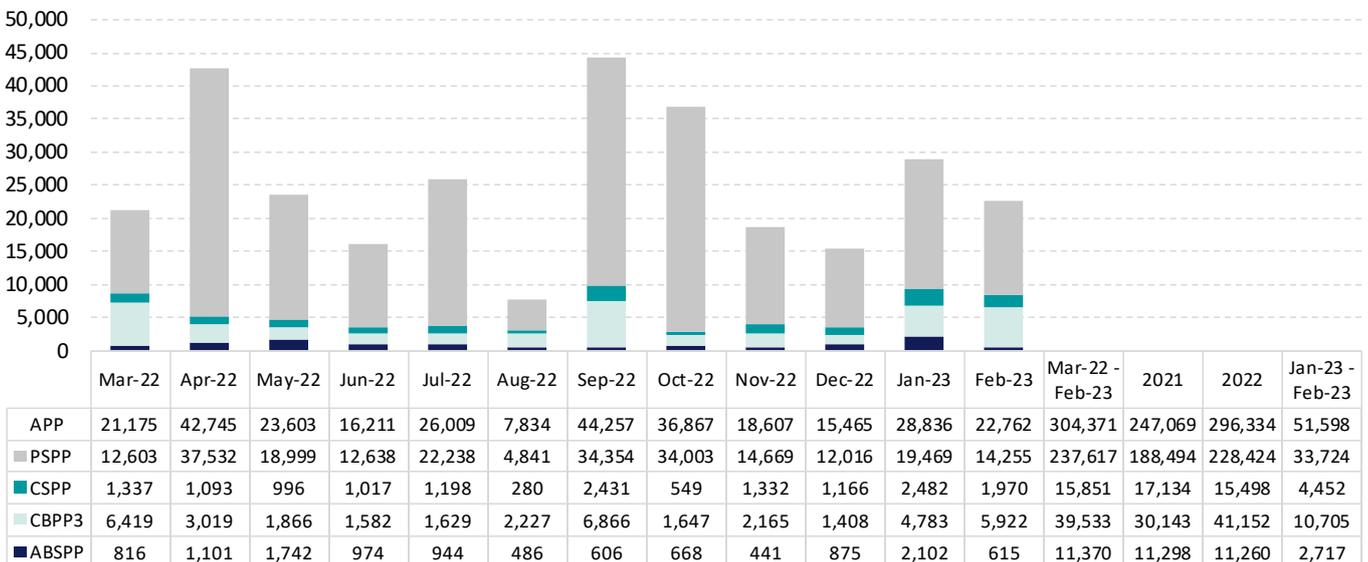
Weekly purchases



Distribution of weekly purchases



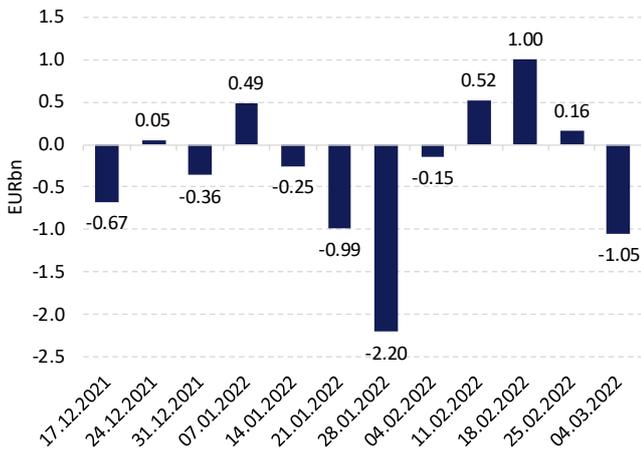
Expected monthly redemptions (in EURm)



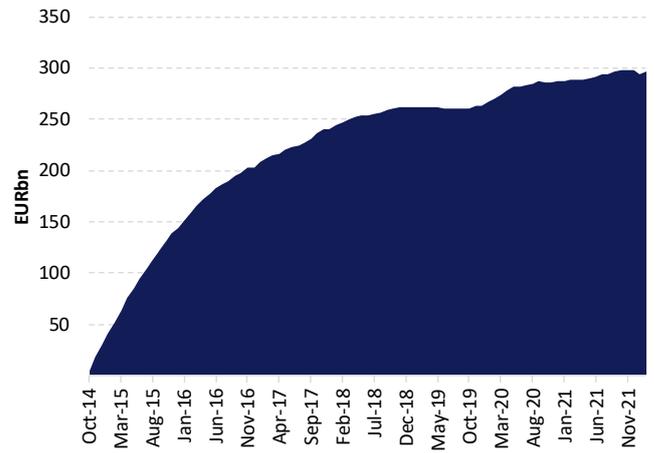
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Covered Bond Purchase Programme 3 (CBPP3)

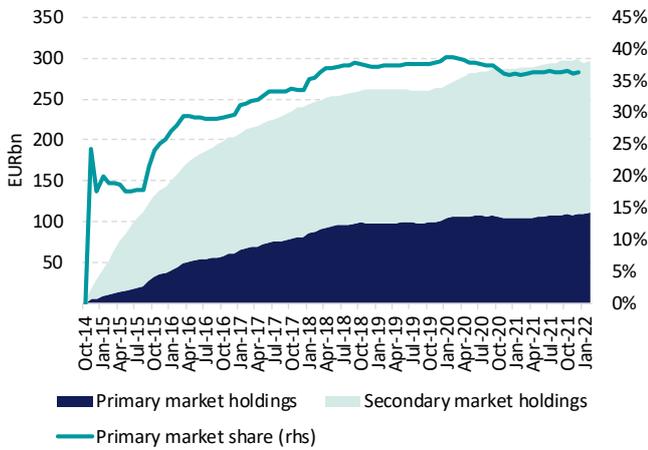
Weekly purchases



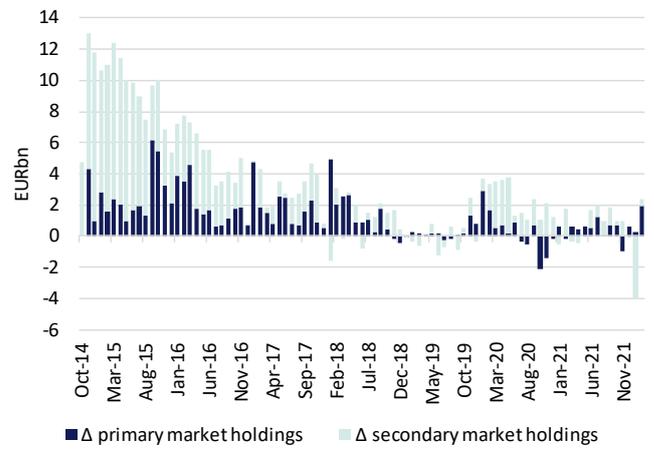
Development of CBPP3 volume



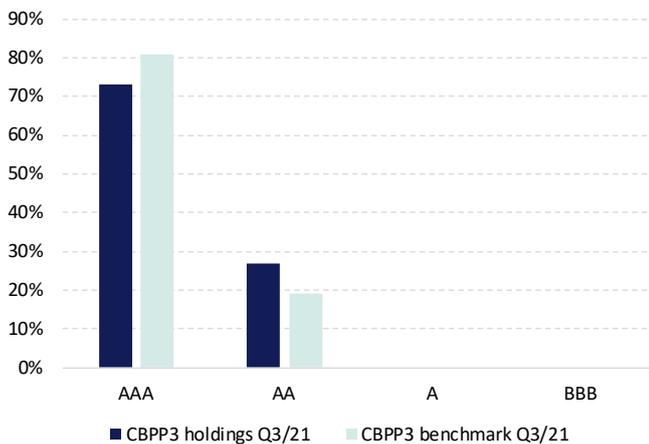
Primary and secondary market holdings



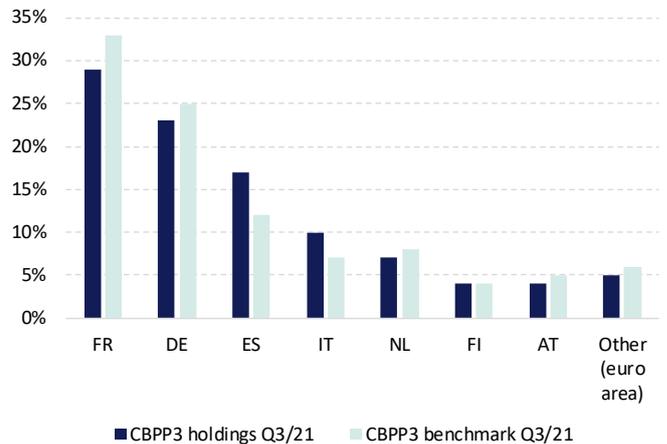
Change of primary and secondary market holdings



Distribution of CBPP3 by credit rating

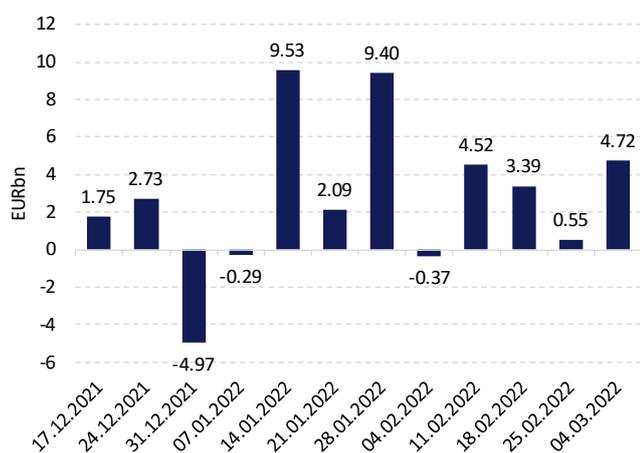


Distribution of CBPP3 by country of risk

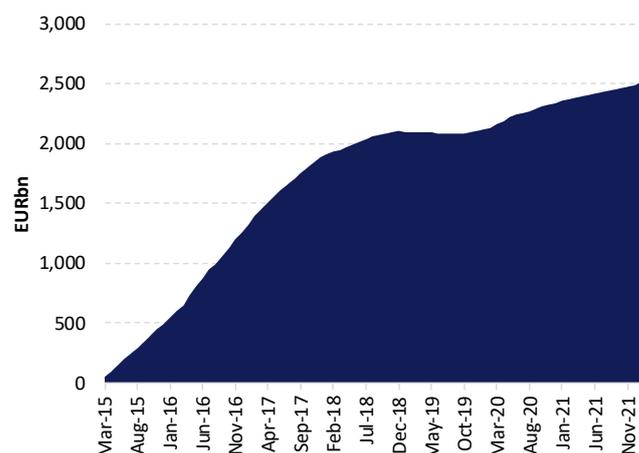


Public Sector Purchase Programme (PSPP)

Weekly purchases



Development of PSPP volume



Overall distribution of PSPP buying at month-end

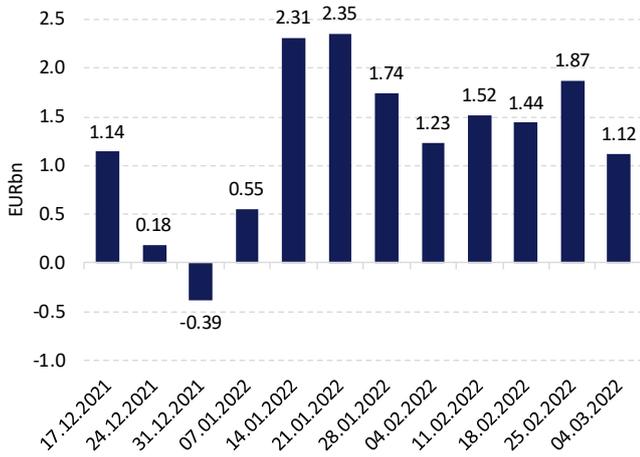
Jurisdiction	Adjusted distribution key ¹	Purchases (EURm)	Expected purchases (EURm) ²	Difference (EURm)	Avg. time to maturity ³ (in years)	Market average ³ (in years) ³	Difference (in years)
AT	2.7%	73,940	71,860	2,080	7.5	7.6	-0.1
BE	3.4%	92,603	89,448	3,155	8.0	10.2	-2.2
CY	0.2%	4,275	5,283	-1,008	9.9	8.8	1.1
DE	24.3%	640,615	647,220	-6,605	6.6	7.6	-1.0
EE	0.3%	414	6,916	-6,502	9.2	7.5	1.7
ES	11.0%	305,586	292,769	12,817	8.0	8.4	-0.4
FI	1.7%	42,422	45,098	-2,676	6.9	7.7	-0.8
FR	18.8%	522,937	501,452	21,485	7.2	8.1	-0.9
GR	0.0%	0	0	0	0.0	0.0	0.0
IE	1.6%	41,963	41,575	388	8.5	10.1	-1.6
IT	15.7%	437,653	417,097	20,556	7.1	7.9	-0.8
LT	0.5%	5,649	14,210	-8,561	10.2	10.6	-0.4
LU	0.3%	3,944	8,087	-4,143	5.6	7.2	-1.7
LV	0.4%	3,440	9,567	-6,127	11.3	10.4	0.9
MT	0.1%	1,375	2,575	-1,200	9.5	9.2	0.3
NL	5.4%	124,353	143,884	-19,531	7.7	9.0	-1.4
PT	2.2%	52,086	57,463	-5,377	7.0	7.2	-0.2
SI	0.4%	10,544	11,822	-1,278	9.9	10.2	-0.3
SK	1.1%	17,322	28,117	-10,795	8.2	8.3	-0.1
SNAT	10.0%	279,373	266,049	13,324	7.7	8.9	-1.2
Total / Avg.	100.0%	2,660,494	2,660,494	0	7.3	8.2	-0.9

¹ Based on the ECB capital key, adjusted to include supras and the disqualification of Greece² Based on the adjusted distribution key³ Weighted average time to maturity of the bonds eligible for purchasing under the PSPP (semi-annual data, Q1/2021)

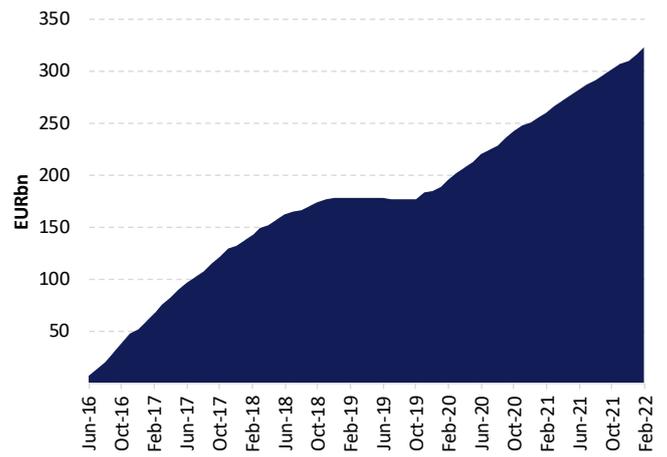
Source: ECB, NORD/LB Markets Strategy & Floor Research

Corporate Sector Purchase Programme (CSPP)

Weekly purchases

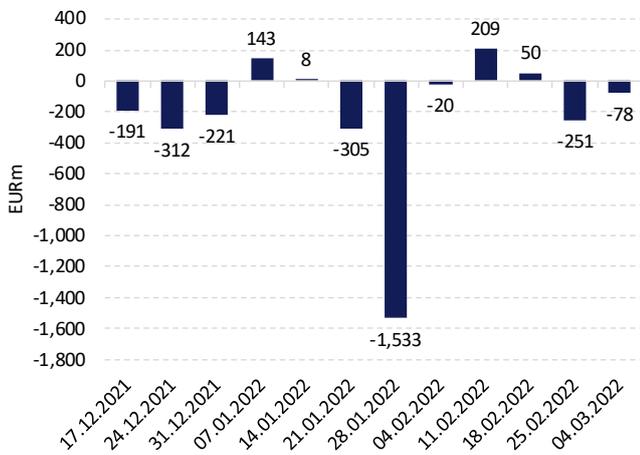


Development of CSPP volume

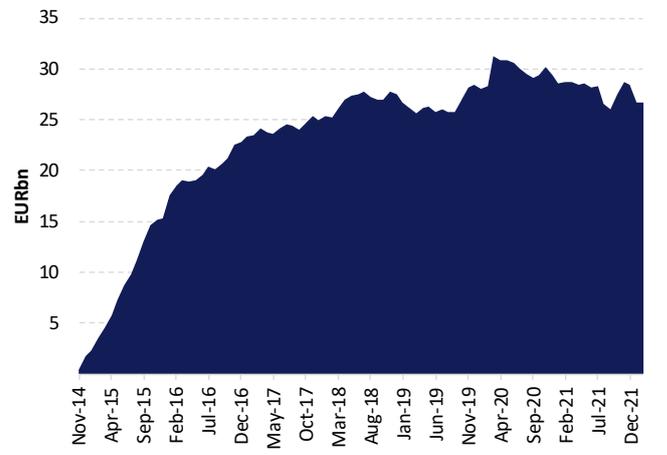


Asset-Backed Securities Purchase Programme (ABSPP)

Weekly purchases



Development of ABSPP volume



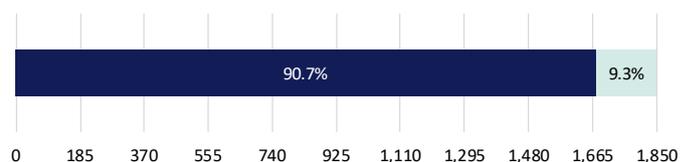
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Pandemic Emergency Purchase Programme (PEPP)

Holdings (in EURm)

	PEPP
Jan-22	1,647,678
Feb-22	1,687,862
Δ	+40,184

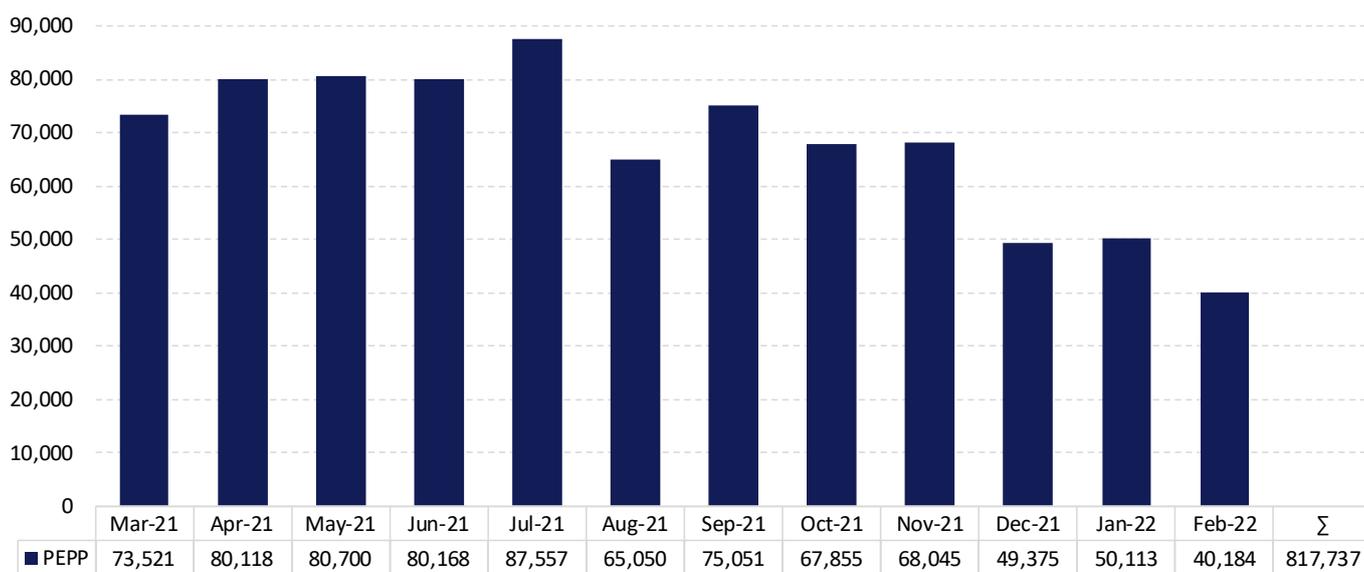
Volume already invested (in EURbn)



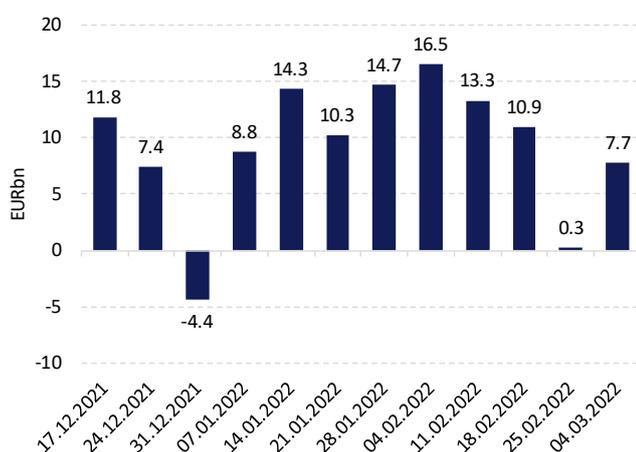
Estimated portfolio development

Assumed pace of purchases	Weekly net purchase volume	PEPP limit hit in ...
Average weekly net purchase volume so far	EUR 16.6bn	10 weeks (13.05.2022)

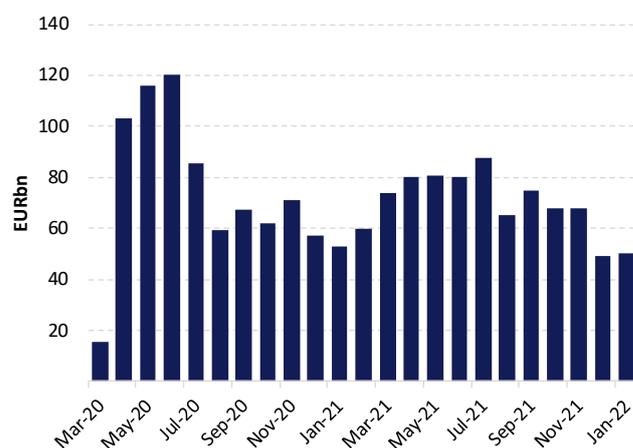
Monthly net purchases (in EURm)



Weekly purchases



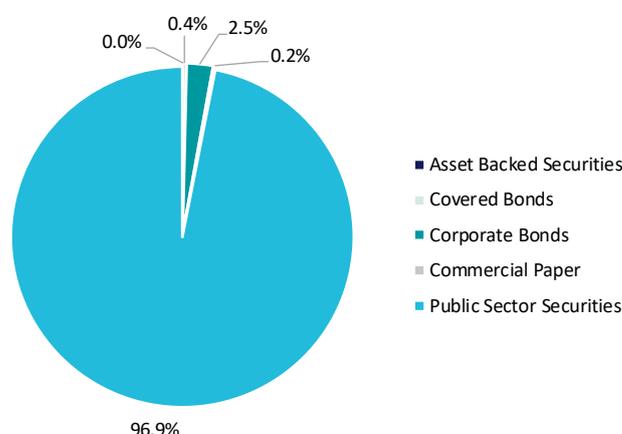
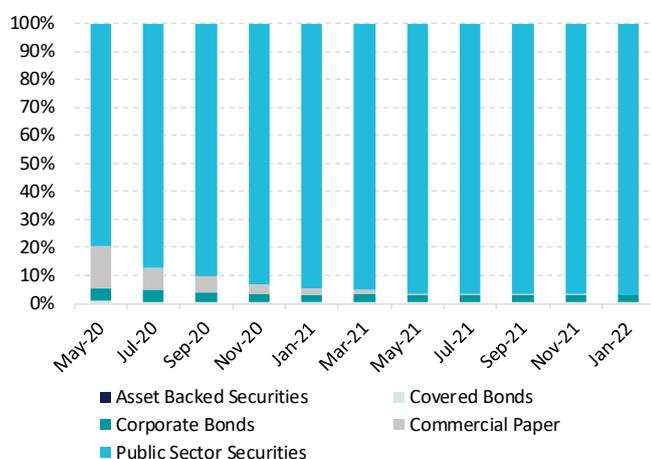
Development of PEPP volume



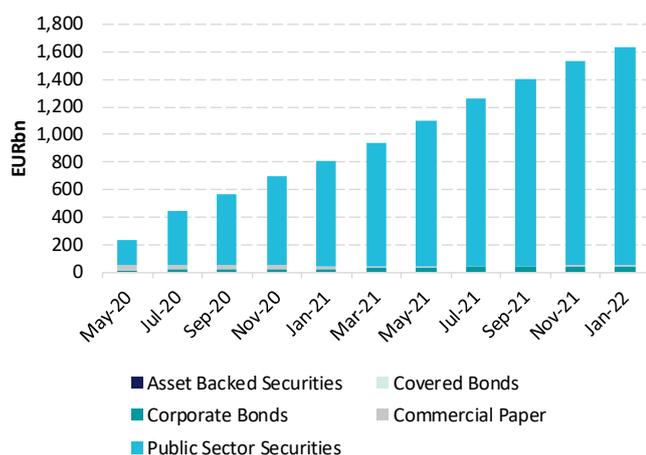
Holdings under the PEPP (in EURm)

	Asset-backed Securities	Covered Bonds	Corporate Bonds	Commercial Paper	Public Sector Securities	PEPP
Nov-21	0	6,079	39,871	4,032	1,485,526	1,535,508
Jan-22	0	6,073	40,301	3,857	1,580,547	1,630,779
Δ	0	0	+467	-172	+99,193	+99,488

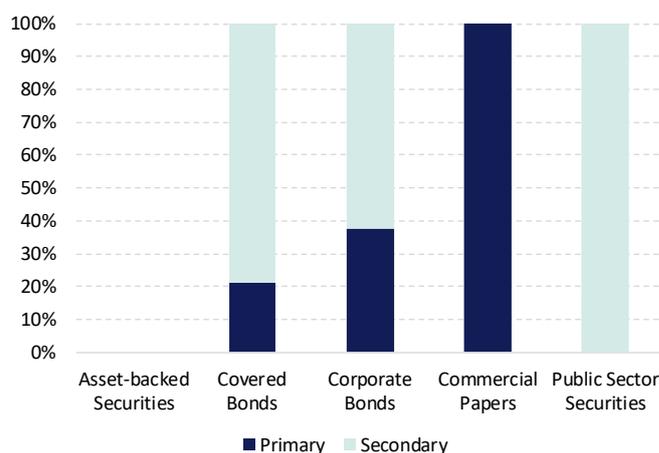
Portfolio structure



Portfolio development



Share of primary and secondary market holdings



Breakdown of private sector securities under the PEPP

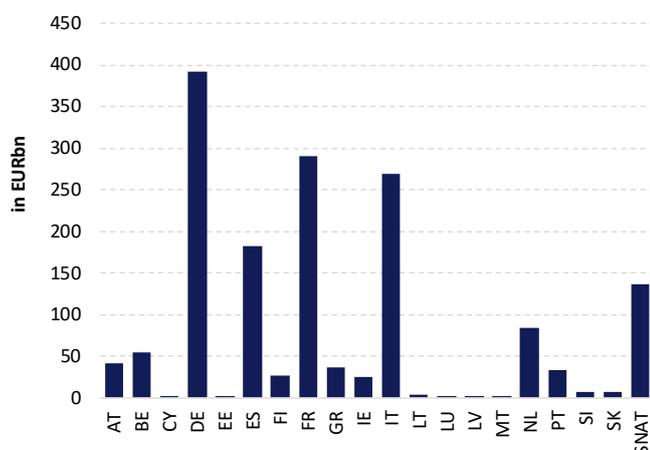
Jan-22	Asset-backed securities		Covered bonds		Corporate bonds		Commercial paper	
	Primary	Secondary	Primary	Secondary	Primary	Secondary	Primary	Secondary
Holdings in EURm	0	0	1,298	4,775	15,101	25,200	3,857	0
Share	0.0%	0.0%	21.4%	78.6%	37.5%	62.5%	100.0%	0.0%

Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

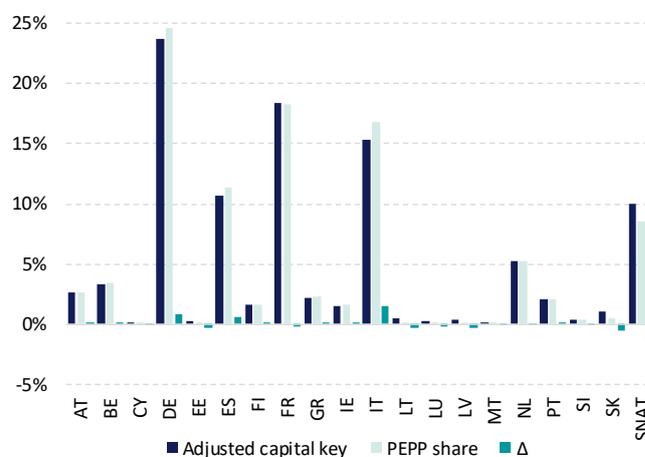
Breakdown of public sector securities under the PEPP

Jurisdiction	Holdings (in EURm)	Adj. distribution key ¹	PEPP share	Deviations from the adj. distribution key ²	Ø time to maturity (in years)	Market average ³ (in years)	Difference (in years)
AT	42,272	2.6%	2.6%	0.0%	8.2	7.0	1.2
BE	54,203	3.3%	3.4%	0.1%	6.6	9.2	-2.6
CY	2,514	0.2%	0.2%	0.0%	8.6	8.1	0.5
DE	392,570	23.7%	24.6%	0.9%	6.2	6.8	-0.6
EE	256	0.3%	0.0%	-0.2%	8.4	8.4	0.0
ES	181,624	10.7%	11.4%	0.6%	7.7	7.5	0.2
FI	26,807	1.7%	1.7%	0.0%	6.9	7.5	-0.7
FR	291,113	18.4%	18.2%	-0.2%	8.1	7.5	0.6
GR	36,876	2.2%	2.3%	0.1%	8.9	9.6	-0.7
IE	25,332	1.5%	1.6%	0.1%	8.9	9.5	-0.6
IT	268,405	15.3%	16.8%	1.5%	7.1	6.9	0.2
LT	3,129	0.5%	0.2%	-0.3%	10.5	10.1	0.4
LU	1,914	0.3%	0.1%	-0.2%	6.3	6.3	0.0
LV	1,710	0.4%	0.1%	-0.2%	9.3	9.2	0.0
MT	544	0.1%	0.0%	-0.1%	10.8	9.0	1.9
NL	83,893	5.3%	5.3%	0.0%	7.6	8.5	-0.9
PT	33,857	2.1%	2.1%	0.0%	6.9	7.3	-0.4
SI	6,311	0.4%	0.4%	0.0%	9.2	9.2	0.0
SK	7,605	1.0%	0.5%	-0.6%	9.2	8.4	0.8
SNAT	136,399	10.0%	8.5%	-1.5%	10.1	8.5	1.5
Total / Avg.	1,597,334	100.0%	100.0%	0.0%	7.5	7.5	0.1

Distribution of public sector assets by jurisdiction



Deviations from the adjusted distribution key

¹ Based on the ECB capital key, adjusted to include supras ² Based on the adjusted distribution key³ Weighted average time to maturity of the bonds eligible for purchasing under the PEPP

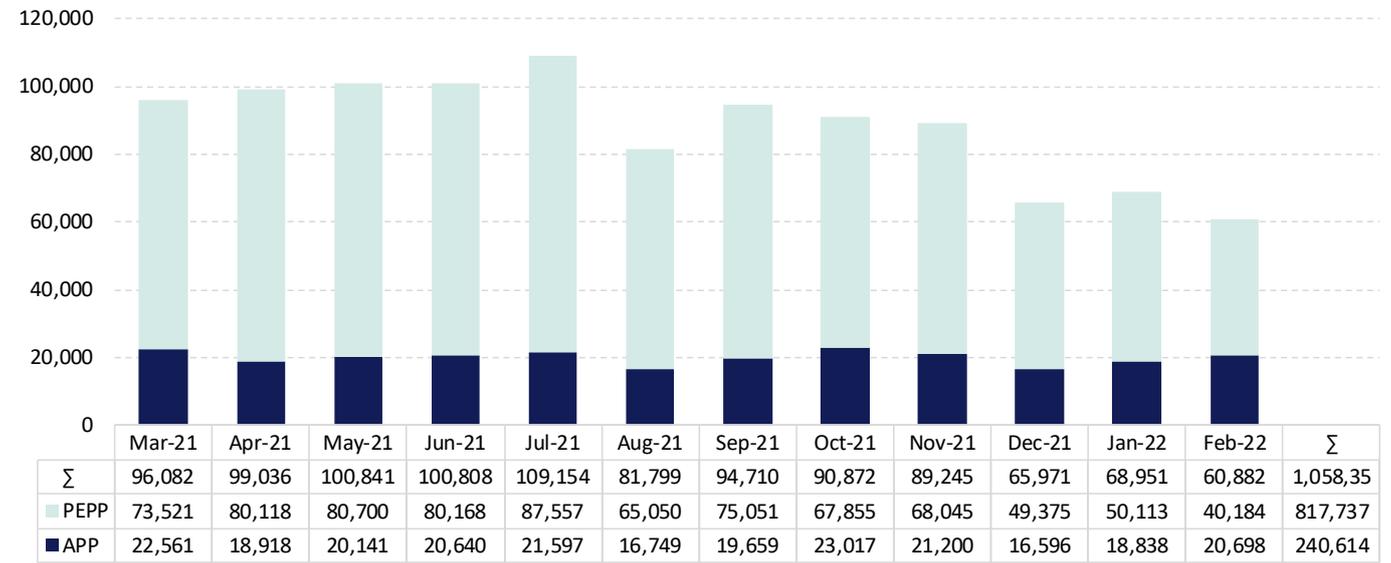
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Aggregated purchase activity under APP and PEPP

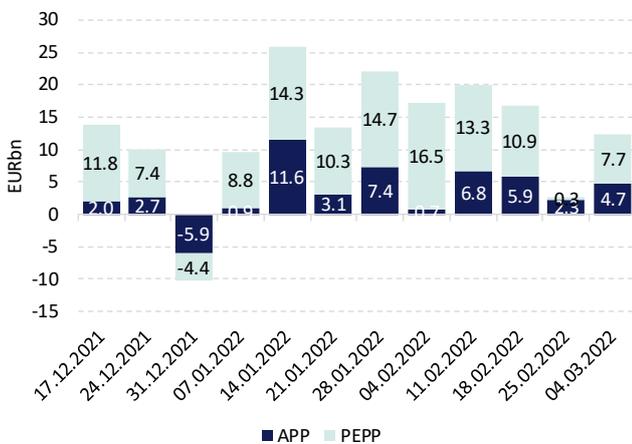
Holdings (in EURm)

	APP	PEPP	APP & PEPP
Jan-22	3,142,221	1,647,678	4,789,899
Feb-22	3,162,920	1,687,862	4,850,782
Δ	+20,698	+40,184	+60,882

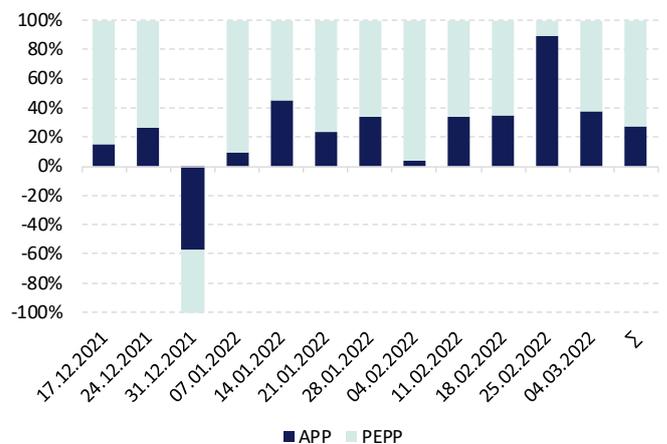
Monthly net purchases (in EURm)



Weekly purchases



Distribution of weekly purchases



Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Appendix

Publication overview

Covered Bonds:

Issuer Guide Covered Bonds 2021

Risk weights and LCR levels of covered bonds

Transparency requirements §28 PfandBG

Transparenzvorschrift §28 PfandBG Sparkassen (German only)

SSA/Public Issuers:

Issuer Guide – German Laender 2021

Issuer Guide – Canadian Provinces & Territories 2020

Issuer Guide – Supranationals & Agencies 2019

Issuer Guide – Down Under 2019

Fixed Income:

ESG update

Analysis of ESG reporting

ECB holds course, but ups the ante – PEPP running until 2022

ECB launches corona pandemic emergency

ECB responds to corona risks

Appendix

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Sales MM/FX	+49 511 9818-9460
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Governments	+49 511 9818-9660
Laender/Regionen	+49 511 9818-9550
Frequent Issuers	+49 511 9818-9640

Sales Wholesale Customers

Firmenkunden	+49 511 361-4003
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Additional information

Time of going to press: 10 March 2022 17:29h (CET)

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None

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Neutral: 55%

Negative: 8%

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Issuer / security	Date	Recommendation	Bond type	Cause
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