



Fixed Income Special

NORD/LB Markets Strategy & Floor Research

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Marketing communication (see disclaimer on the last pages)

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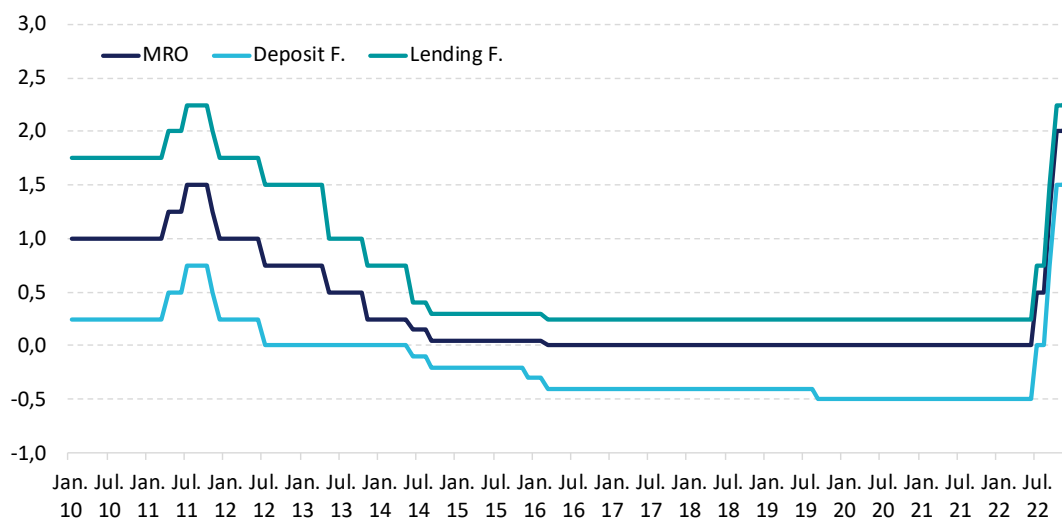
ECB: The Wishing-Table, the Gold-Ass, and the Cudgel in the Sack

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ECB decision: 50 basis points as expected

At its meeting today, the Governing Council again decided to raise all three key interest rates. Contrary to the previous two interest rate hikes of 75 basis points, an increase of 50 basis points each was announced earlier today. Accordingly, the interest rates for the main refinancing operations as well as the interest rates for the marginal lending facility and the deposit facility will be 2.50%, 2.75% and 2.00%, respectively, effective December 21, 2022. The Governing Council of the ECB continues to assume that further significant interest rate steps will be necessary, also in order to contain the risk of a permanent upward shift in inflation expectations in the long term. It is therefore not surprising that the "meeting-by-meeting" approach continues to be followed when it comes to the extent of the next interest rate steps. The new inflation projections also provide an insight into the basis for the monetary authorities' decisions. An average of 8.4% is now expected for 2022, while the projections for 2023 (6.3%), 2024 (3.4%) and finally 2025 (2.3%) hold out the prospect of a moderating inflation rate.

ECB key interest rates (in %; incl. current interest rate decision)



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

End of full reinvestment under the APP as of March 2023

As we expected in our ECB preview last week, today's press release also provides information on the further handling of the securities purchase program (APP). Accordingly, the full reinvestments will continue until the end of February 2023, with a "moderate and predictable" reduction of the APP starting in March 2023. Until the end of Q2 2023, the Governing Council announces a reduction by an average of EUR 15bn, leaving the subsequent pace still open. For the PEPP, as expected, full reinvestment will continue to be maintained until at least the end of 2024. The ECB plans to communicate the exact parameters in the context of the reduction of the APP at the first meeting in 2023 (02 February). In principle, the Council reserves the right to "regularly reassess" the pace of the APP reduction.

Implications of today's ECB decision for public sector issuers (SSAs)

This morning, the EIB kicked off the approved funding for 2023: EUR 45bn are stated, up to EUR 50bn they are allowed by the board to issue to have enough flexibility. After this weekend, right on Monday we expect KfW figures (NORD/LB forecast: EUR 80-85bn), followed by EU funding figures on Tuesday for H1/2023. With SURE now fully processed, all market participants are increasingly focusing on NGEU and MFA for Ukraine. We expect a minimum of EUR 50-60bn for NGEU alone. We will have to wait a few more weeks for the credit allowances from the German Laender to be stated. We strongly believe that today's interest rate decision will not have a particularly negative impact on the refinancing ability of supranationals, German Laender or e.g. KfW. Supras do not operate in a vacuum, but if order books are oversubscribed several times, it is here in this sub-segment, as the 20-fold (!) oversubscription in the last EU transaction last week showed. Moreover, the +50bp rate move was already expected and priced in by most market participants anyway. We expect primary market activity to pick up directly on January 02 and very calm seas until then. This sounds more contemplative than the rough ride in much of 2022. The (somewhat procrastinated) QT naturally plays the biggest role for the public sector due to the 80% share of the PSPP in the total APP. We will therefore closely monitor the slow reduction of the balance sheet total.

Impact on the covered bond market

In our view, today's ECB key rate decision does not hold any major surprise element. The 50bp rate hike was generally expected. The fact that there were no adjustments to the longer-term refinancing operations (TLTRO) or their conditions today was also considered comparatively certain. The announcements on the APP, indicating an end to full-scale reinvestment, now provides a bit more clarity on the timing and details of further balance sheet reduction via QT. For the forecasts on covered bond supply and spread development put on paper in our recent "NORD/LB Outlook 2023", no need for adjustment emerges from today's announcement. What we would by no means rule out is an even stronger focus by issuers on the months of January and February when it comes to their primary market appearances. In addition, there is an increased probability of sentiment-driven and thus rather temporary widening of spreads.

Conclusion and comment

Today's key rate decision once again reveals how serious the monetary authorities are about combating persistently high inflation rates and the risk of inflation expectations being anchored at sustainably higher levels. This also applies to a somewhat "smaller" interest rate step of 50 basis points. Finally, the interest rate decision is flanked by a thoroughly drastic, albeit not unexpected, change in direction with regard to the APP. The fact that the Council is giving some time for preparation here is just as expected as the announcement of a cautious approach. Even though it was announced today that the pace of reducing the APP portfolio would be reassessed on a regular basis, we see a certain "bias" towards a cautious pace as rather likely. Thus, in our view, the concern to "maintain the market's ability to function" is likely to be given a notable preponderance. The reduction of the portfolio will not take place entirely without spread widening. Nevertheless, today's announcement is broadly in line with general market expectations, so we would not read a change of direction into it.

Appendix

Publication overview

Covered Bonds:

[Issuer Guide Covered Bonds 2022](#)

[Covered Bond Directive: Impact on risk weights and LCR levels](#)

[Risk weights and LCR levels of covered bonds](#) (updated semi-annually)

[Transparency requirements §28 PfandBG Q3/2022](#) (quarterly update)

[Covered bonds as eligible collateral for central banks](#)

SSA/Public Issuers:

[Issuer Guide – German Laender 2022](#)

[Issuer Guide – German Agencies 2022](#)

[Issuer Guide – Dutch Agencies 2022](#)

[Beyond Bundeslaender: Greater Paris \(IDF/VDP\)](#)

[Spotlight on Belgian regions](#)

[Spotlight on Spanish regions](#)

Fixed Income Specials:

[ESG-Update 2022](#)

[ECB interest rate decision: delivered as expected?](#)

[ECB acts as the 'House of Hikes' - or: Winter is coming!](#)

[ECB frontloads rate hike by +50bp and breaches pre-commitment](#)

[ECB ready for lift-off: Every journey starts with a first step](#)

Appendix

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