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Fixed Income Special

NORD/LB Markets Strategy & Floor Research

2 February 2023

Marketing communication (see disclaimer on the last pages)

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ECB interest rate decision: Roadmap to QT

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

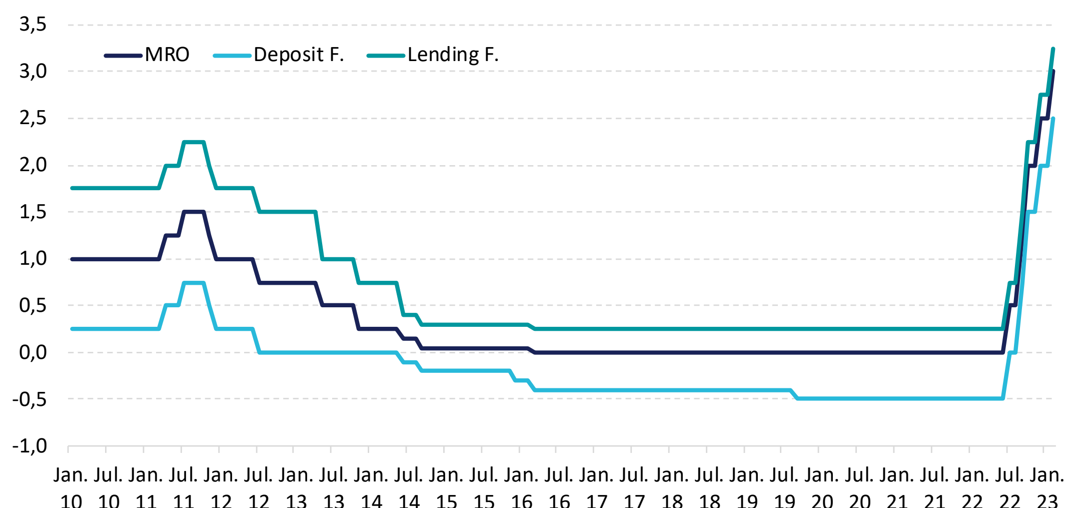
ECB decision: +50bp as expected at all the key interest rates

At its regular meeting today, the ECB Governing Council decided, as expected, to raise all three key interest rates again by 50 basis points. This already seemed to be a foregone conclusion after the last press conference in December 2022, when President Lagarde had held out the prospect of several increases on this scale. Accordingly, the interest rates for the main refinancing operations as well as the interest rates for the marginal lending facility and the deposit facility are 3.00%, 3.25% and 2.50%, respectively. The Governing Council continues to assume that further interest rate steps will be necessary – above all to sustainably contain the existing risk of inflation expectations being permanently shifted upward. In view of this, another hike of 50bp is intended in March. In addition, the “meeting-by-meeting” approach is to be followed, although we would like to refer admonitively to the last press conference at which something like hawkish guidance was launched at the “meta level”. Therefore, it was more true than ever at today's meeting: All ears open at the press conference! Since the interest rate step was already certain for the majority of market participants, the focus of today's ECB key rate meeting was therefore on the new information or on the parameterization of reinvestments under the APP. New projections regarding inflation and economic growth were not published today, these take place four times a year and thus “only” with the next meeting in March.

Preliminary reinvestment roadmap: The parameters until the end of Q2 are there!

Today, the parameters for the APP portfolio reduction were announced: Reinvestments are to be made by the end of Q2 largely in line with current practice. There are no plans to reallocate between the individual programs. For the PSPP, the ECB also intends to reinvest amounts in equal proportion to maturities with respect to jurisdictions (including supranationals). As expected, there were no changes regarding reinvestments in the PEPP. The details can be found here.

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



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

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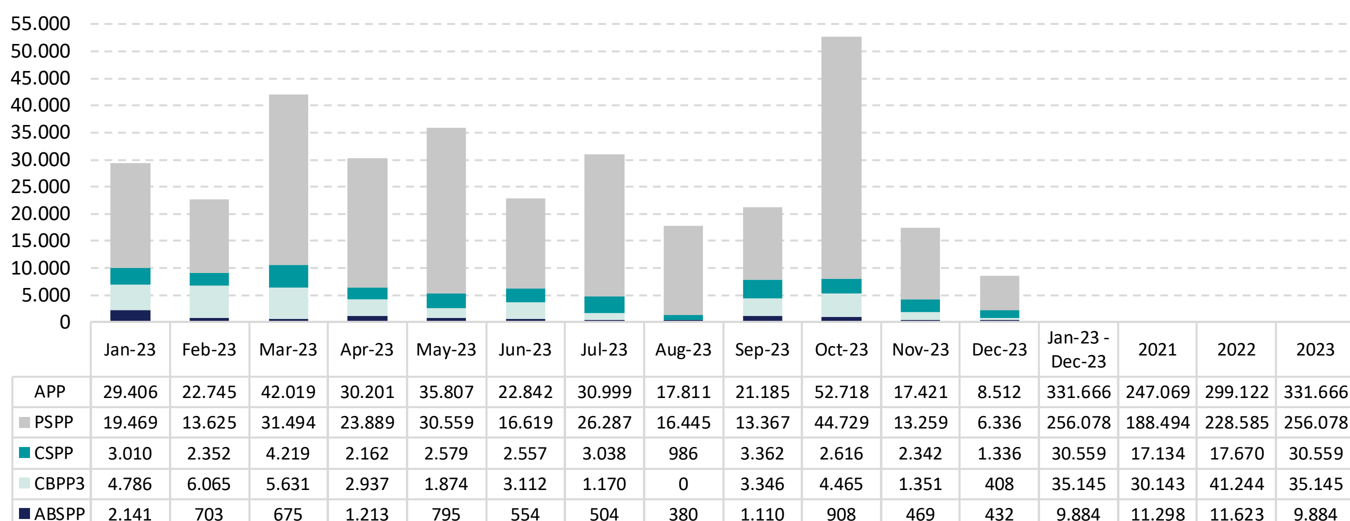
APP: Expected monthly redemptions (in EURm)



	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-23 - Dec-23	2021	2022	2023
APP	29.406	22.745	42.019	30.201	35.807	22.842	30.999	17.811	21.185	52.718	17.421	8.512	331.666	247.069	299.122	331.666
PSPP	19.469	13.625	31.494	23.889	30.559	16.619	26.287	16.445	13.367	44.729	13.259	6.336	256.078	188.494	228.585	256.078
CSPP	3.010	2.352	4.219	2.162	2.579	2.557	3.038	986	3.362	2.616	2.342	1.336	30.559	17.134	17.670	30.559
CBPP3	4.786	6.065	5.631	2.937	1.874	3.112	1.170	0	3.346	4.465	1.351	408	35.145	30.143	41.244	35.145
ABSPP	2.141	703	675	1.213	795	554	504	380	1.110	908	469	432	9.884	11.298	11.623	9.884

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

Musings on the further QT roadmap

As a reminder, at the previous ECB meeting on December 15, 2022, the Council decided to reduce holdings from the APP at a measured and predictable pace from the beginning of March. Specifically, it was communicated that maturities would no longer be fully reinvested from March until the end of Q2, but would be reduced by an average of EUR 15bn per month. The chart above shows the maturities of the program. From March to the end of June, maturities totaled EUR 130.9bn. Obviously, the amount not reinvested totals EUR 60bn. Therefore, in percentage terms, only around 54% will be reinvested – significantly less than we would have expected in the old year. Let us engage in a thought experiment: It is conceivable that the pace of inventory reduction in Q3 and Q4 will remain at the same high level or even pick up further. If the ECB continues to reinvest "only" EUR 15bn less on a monthly average in Q3, the reinvestment ratio would already have fallen to around 36%. In Q4, maturities of EUR 78.7bn are to be expected due to October (EUR 52.7bn then alone). It is therefore quite conceivable that the amount not reinvested will then be increased to an average of EUR 20bn, resulting in a reinvestment ratio of at most 24% (or even less) and finally no more reinvestments from 2024 onwards.

Shifts towards ESG or even between programs and/or jurisdictions in the future?

It would also be conceivable somewhen in the second half of the year that reallocations could be made between the PSPP, CBPP3 and CSPP programs. The ABSPP can remain unmentioned here due to its "size". Or – since there are no prohibitions on thinking – the ECB may deviate more from the ECB capital key between the individual jurisdictions or Supras under the PSPP as part of its flexibility. Further, ESG could also become more of a focus for reinvestment: For the CSPP, it was already announced in July 2022 that reinvestment in issuers with a better climate balance is to be increased. To the extent that this can be done without compromising the ECB's price stability target, this approach supports the gradual decarbonization of the Eurosystem's holdings of corporate bonds in line with the objectives of the Paris Agreement. Why should this not also apply to public or covered bond issuers in the future?

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

All quiet on the Western front: Supras do not operate in any vacuum of the above-mentioned interest rate steps, but if order books are several times oversubscribed, it is here in this sub-segment. The EIB brought its ten-year bond (EUR 5bn) at 4.5 times over-subscription. The coupon was 2.875%. Not to mention the multiple oversubscribed book of the EU tap. Moreover, the interest rate step of +50bp was already anticipated by most market participants anyway and thus priced in. Admittedly, the current wave of issuance shows that it makes sense to achieve the first funding successes as early as possible in January. The German states are currently exercising only partial restraint. Here, it was particularly exciting to have already seen NIESA twice with EUR 750m each. SAARLD, BRABUR, HESSEN and especially NRW (dual tranche) have also already been extremely successful in the market. However, the slow but progressive exit of the ECB from the purchase programs could shake the spread differences to the core in the medium term and lead to a gain in significance of the fundamental differences.

Impact on the covered bond market

In our view, today's decisions and announcements by the ECB Council do not provide fresh impetus for the covered bond segment. Thus, the course continues after the Eurosystem loosens its grip from the covered bond market. A possible influencing factor that would have led us to adjust our expectations with regard to the issuance pattern or spread developments would have been an adjustment of reinvestments with a view to the sectoral weightings in the individual purchase programs. In this case, however, central bankers are sticking to reinvesting maturities where they occur. In the TLTRO III tenders, we are also struck by the Council's now more observational role. The ECB will probably follow the further reduction of the balance sheet from the sidelines here. With the announced parameters in APP reinvestments or in the context of QT, the focus remains on the ECB order share in the covered bond primary market. After no adjustment has been made so far in February, we actually expect a reduction to 10% with the first "March settlement date". There will then be some slight widening here, with a large proportion of the monetary policy turnaround already having been factored into the market, also in view of the specific influences on the covered bond market. February is likely to be quite busy again on the primary market.

Conclusion and comment

We tell the joke of the day right away: the "meeting-by-meeting" approach and the self-imposed data dependency is countered by the ECB itself by letting us know already at 14:15 in the press release that it would require +50bp again in March (16.03.). Much more pre-determination is not possible and in 2022 it came several times differently, so in our opinion +25bp in May (04.05.) are also set and only the June meeting will let us know whether in May is really already the end of the line with regard to rate hikes. Exciting was the wait for the details for the upcoming QT from March 2023, when an average of EUR 15bn per month will not be reinvested until the end of Q2. There were more details at 15:45 in another press release. Not in focus for us, but possibly more than just a test balloon: under the CSPP, the amounts remaining for reinvestment will be more focused on issuers with better climate performance. We would also like to extend the APP to public issuers and/or covered bonds in the second half of the year and then terminate the APP at the end of 2023.

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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: Belgium

Beyond Bundeslaender: Greater Paris (IDF/VDP)

Spotlight on Spanish regions

Fixed Income Specials:

ESG-Update 2022

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

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

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