Morning Comment

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AFS Insights

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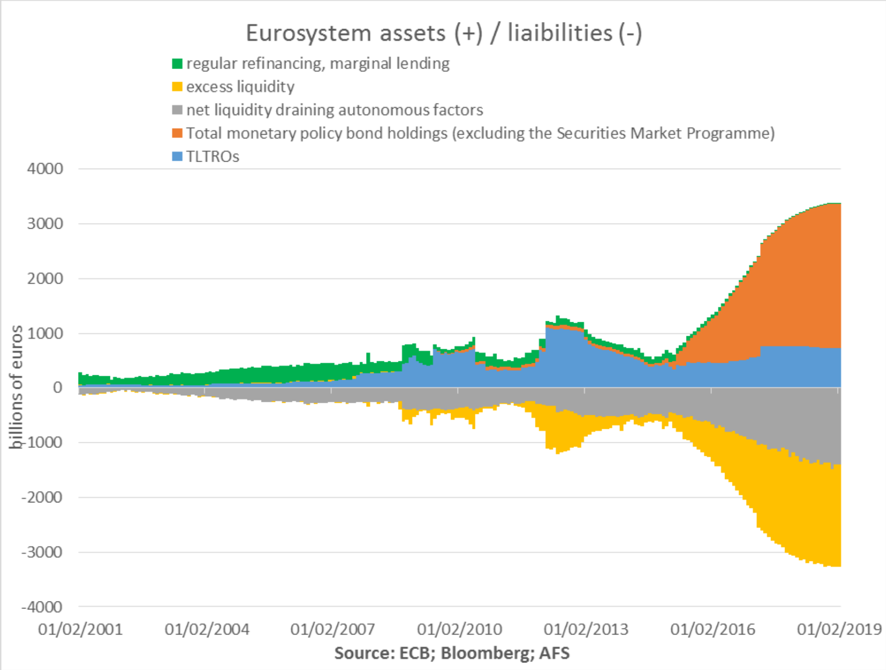
Headline Sweep

- EU to agree Brexit delay but France pushes for conditions
- Italy's Government Sees Economy Effectively Stagnating This Year
- Fed to Review Inflation Targeting, Policy Tools and Communications
- Commerzbank Staff Call For Vote to Scupper Deutsche Deal: FT

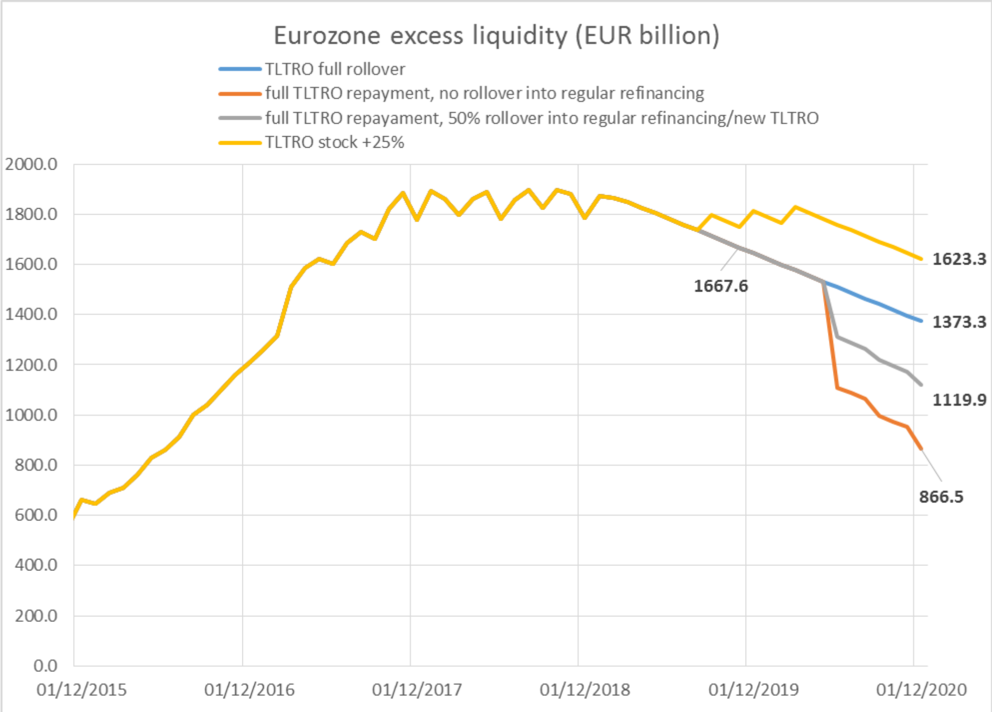
Full stories can be read in the AFS Morning Note

The Day Ahead

- **While we previewed today's ECB meeting on Monday (summary: it won't be exciting, to say the least), we have a few more things to say about what Draghi & Co are up to.** As mentioned in Monday's Comment, a key determinant of Eurozone money market conditions is the uptake at the upcoming TLTRO-iii auctions in September, December and March. That, plus how far the ECB is willing to go in exempting banks' excess reserves from the negative deposit rate. In today's Comment we will take a closer look at the former (the TLTROs that is).
- **As we've mentioned every now and then, the ECB's balance sheet is stable since the start of the year because QE has ended.** Here's the chart:



Since assets are no longer growing (they're flat), excess liquidity is simply a function of changes in so-called net liquidity draining autonomous factors. While most 'factors' (a terrible word) are volatile and unpredictable, the biggest liquidity draining factor – currency in circulation – tends to grow at a stable linear pace. Hence, at one point excess liquidity will start to fall because of the public's ever-increasing demand for paper currency. That should become visible late in the second quarter and in the third quarter, with excess liquidity dropping below 1.8 trillion euros before falling to 1.67 trillion euros by year end. Mind you, this is simply extrapolating the growth in paper currency: developments in other autonomous factors can result in a higher or lower level of excess liquidity. Here's the chart:

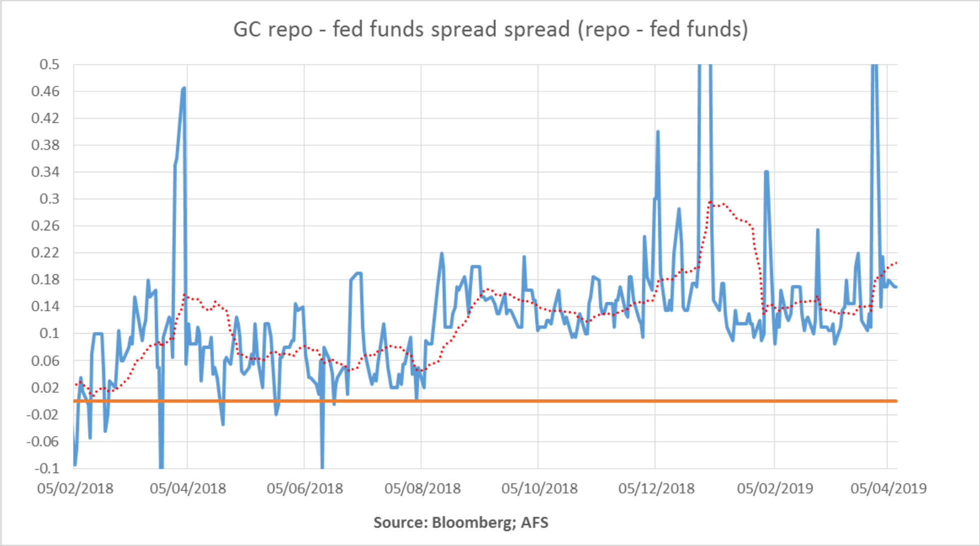


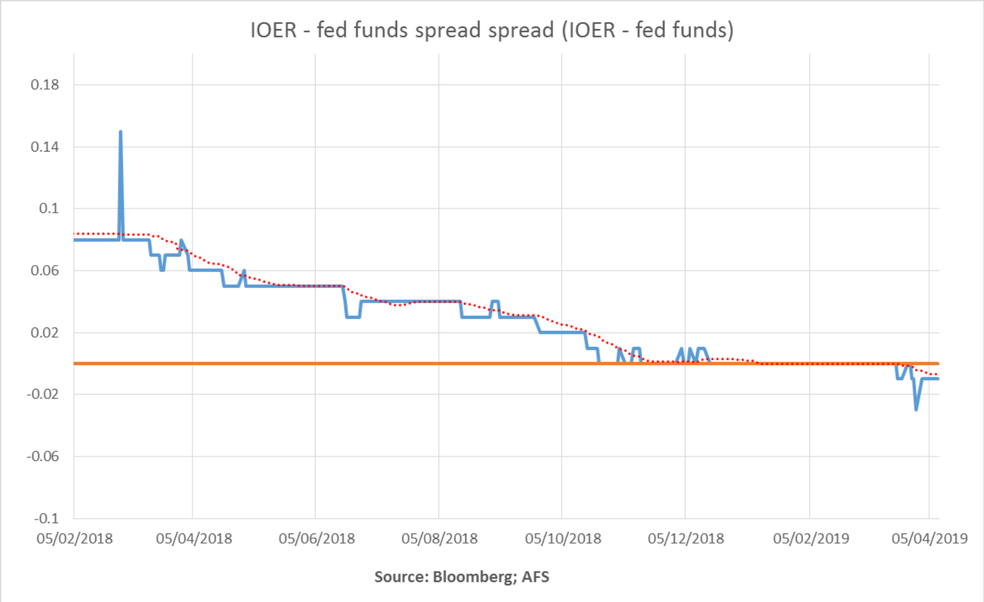
Source: Bloomberg; ECB; AFS

- **As the chart above shows, TLTROs are clearly the wildcard for liquidity conditions in the Eurozone**. If we simply assume that banks will be rolling over the old TLTROs that mature between June 2020 and March 2021, excess liquidity will decline gradually in the next 21 months because of the growth in liquidity draining factors. But a low net uptake – say only 50% rollover – will exacerbate the decline in excess liquidity. On the other hand, banks can still expand their stock of TLTRO loans. With the stock of TLTROs of less than 730 billion euros, banks have borrowed only about 40% of the amount that they are allowed to borrow under the scheme. That's why we also charted a 25% increase in the stock of TLTROs, which will keep liquidity conditions table until June 2020, when the first batch of the old TLTROs start to mature.
- **Our call is that banks will simply be fully rolling over old TLTROs into new ones, which will keep the size of the ECB's balance sheet stable.** It goes without saying that we will have to wait until September to find out if we're right.
- **In the meantime, the ECB will likely sound a bit more dovish today than at the March meeting, when Draghi & Co kicked rate hikes into the long grass by shifting out the implicit timing of the first rate hike to after the end of the year.**

Still disappointing survey data, core inflation readings, trade uncertainty and Brexit will be more than enough reason for dovish undertones. But in the greater scheme of things these dovish undertones will not herald another policy shift. The tightening bias will stay, and only the prospect of a recession (or something similarly scary) will result in the ECB reverting its stance to something dovish.

- **With regards to the FOMC minutes, a key thing to watch is the discussion about the introduction of a new standing repo facility to quell spikes in repo rates, which have a habit of putting unwanted upward pressure on the fed funds rate**. For example, during the March quarter turn repo spike to more than 50bps above the fed funds. In turn, fed funds spiked to 3bps above the interest on excess reserves rate:





- **So it's easy to see the Fed designing another repo facility (they already have a reverse repo facility that acts as the interest rate corridor's floor)** so that the repo spikes are less pronounced. However, since the Fed probably doesn't want much of a footprint in repo markets when trading is regular and orderly, the borrowing rate will have to be above the General Collateral (GC) repo rate by some margin. And that brings us to the heart of the matter. The repo facility will not address the upward drift in the fed funds rate stemming from the decline in excess liquidity as the balance sheet continues to shrink until the end of September. Furthermore, the public's demand for paper currency continues to grow in the US at a stable linear pace, just like in the Eurozone. When QT is expected to end in September, liquidity conditions will continue to tighten passively.

Calendar

TIME	REGION	EVENT	PERIOD	ACTUAL	CONSENSUS	REVISED	PRIOR
01:50	Japan	Core Machine Orders MoM	Feb	1.80%	2.80%		-5.40%

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:45	France	Industrial Production MoM	Feb	-0.50%	1.30%
08:45	France	Industrial Production YoY	Feb	-0.20%	1.70%
10:00	Italy	Industrial Production MoM	Feb	-0.50%	1.70%
10:00	Italy	Industrial Production WDA YoY	Feb	--	-0.80%
10:30	Denmark	Sells Bills			
10:30	UK	Trade Balance	Feb	-£3789m	-£3825m
10:30	UK	Industrial Production MoM	Feb	0.10%	0.60%
10:30	UK	Industrial Production YoY	Feb	-0.90%	-0.90%
10:45		Riksbank's Ohlsson Gives Speech			
11:00	Greece	CPI EU Harmonized YoY	Mar	--	0.80%
11:00	Italy	Sells Bills			
11:30	Germany	Sells 3 Billion Euros of 0% 2024 Bonds			
12:00	Portugal	CPI EU Harmonized YoY	Mar F	--	0.80%
12:00	Finland	Sells 0.5% 2026 Bonds; 1.375% 2047 Bonds			
13:45		ECB Interest Rate Decision			
13:45		ECB Main Refinancing Rate	Apr/10	0.00%	0.00%
13:45		ECB Marginal Lending Facility	Apr/10	0.25%	0.25%
13:45		ECB Deposit Facility Rate	Apr/10	-0.40%	-0.40%
14:30		ECB's Draghi Speaks in Frankfurt After Policy Decision			
14:30	US	CPI MoM	Mar	0.40%	0.20%
14:30	US	CPI Ex Food and Energy MoM	Mar	0.20%	0.10%
14:30	US	CPI YoY	Mar	1.80%	1.50%
14:30	US	CPI Ex Food and Energy YoY	Mar	2.10%	2.10%
19:00	US	Sells USD24 Bln 10-Year Notes Reopening			
20:00		ECB's Coeure Speaks in Washington			
20:00	US	FOMC Meeting Minutes	Mar/20	--	--
20:00	US	Monthly Budget Statement	Mar	-$196.9b	-$234.0b
		EU Brexit Emergency Summit			

Consensus data: Bloomberg News; All Times Are in Central European Time