Morning Comment

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AFS Insights

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Headline Sweep

- Italy's Five Star Weighs Offer of EPP-Led Pro-EU Bloc: Stampa
- Juncker Wants Italy's Five Star in Pro-EU Bloc, Stampa Says
- Euroskeptic Nationalists Edge Closer to Government in Estonia

Full stories can be read in the AFS Morning Note

The ECB's admission of defeat

- **The key risk event in the Eurozone this week is without a doubt the ECB meeting.** However, do not expect the ECB to reveal the full operational details of the new TLTROs just yet. Furthermore, it's also too soon for Draghi & Co to announce operational details of a tiered deposit facility. In fact, the proverbial tealeaves suggest that the Governing Council has only just agreed on tiering, or is close to agreeing.
- **ECB-speakers have mentioned that the full operational details of the TLTROs will be announced in June**. A key design feature that the ECB hasn't yet revealed is the so-called 'teaser rate'. The teaser rate is the rate that will apply if the banks meet certain lending conditions. Consensus surveys from Reuters and Bloomberg give the impression that the teaser rate will be a very important factor. The more the ECB rewards banks for kick-starting lending, the bigger the credit impulse for the sagging Euro Area economy. Or so the reasoning goes.
- **However, unlike three years ago, when the ECB launched the prior batch of TLTROs, credit growth isn't in the doldrums.** In fact, bank lending has been rising at a 3.0% annual pace. That's broadly in line with nominal GDP growth (or at least what nominal growth was before growth rates started to tumble a year ago) and exactly where the ECB would want it to be, given elevated levels of private sector debt. Furthermore, our analysis of the ECB's latest Bank Lending Survey from January showed that for the Euro Area as a whole the cost of credit isn't the issue. Real corporate bank lending rates are close to zero, or even negative. The survey also showed that credit standard and conditions weren't getting any tighter in a significant way. The problem is loan demand. And the 25bps reduction in the borrowing rate that Bloomberg consensus has penciled in will not lift loan demand in a meaningful way.
- **A much more important factor is what will happen to the stock of TLTROs.** There's close to 730 billion euros outstanding under the current TLTRO-iis, which

mature between June 2020 and March 2021. Bloomberg consensus expects an uptake of 410 billion euros in total under the TLTRO-iii. The question is if banks will simply be rolling over the old TLTROs into new ones, or if there will be additional borrowing, meaning that the stock of outstanding TLTROs will increase.

- **The most important determinant for the stock of outstanding TLTROs is the amount of eligible loans that the banks have 'pledged' at the ECB.** If we simply assume that banks have mostly 'used up' eligible loans for the current TLTRO-iis, then at best there can be a marginal increase in the stock of outstanding TLTROs.
- **If the stock of outstanding TLTROs increases, the by definition the ECB's balance sheet will increase by the same amount.** Given the ECB's tightening bias, we'd be surprised if the ECB would allow its balance sheet to increase once again. After all: the ECB has tried to offset growth disappointments by delaying tightening, not by abandoning tightening altogether or by easing policy. Nothing in ECB-speak suggests the ECB is willing to abandon its tightening bias. More importantly, the borrowing rate of the new TLTROs is indexed to the MRO. That means that the TLTRO borrowing rate will increase with rate hikes – a tightening bias by design. Finally, the maturity of the new TLTROs of just two years – half compared to the old ones – is a clear-cut signal where the ECB thinks policy is headed.
- **Bottom line, we believe the ECB will make sure that the stock of TLTROs will remain broadly unchanged, and that banks will simply be rolling over old TLTROs into new ones. L**iquidity conditions will thus continue to tighten passively. Net autonomous liquidity draining factors (principally currency in circulation) will continue to grow, while the size of the ECB's balance sheet will remain unchanged.
- **Turning to the tiered deposit rate, the ECB is giving a clear signal that policy rates will stay on hold even longer.** After all, why introduce a tiered deposit rate now if policy rates will finally be increased in the not too distant future?
- **Our call has always been that if the US yield curve inverts and if the Fed moves towards easing (either to prevent a recession or because of a recession is already happening), then the window of opportunity for the ECB to normalize policy will have closed.** We're now in what can only be described as the ECB's nightmare scenario, where the Fed's next step is easing. So, the tiered deposit rate should be seen as an admission of defeat. This cycle the ECB will not be able to normalize monetary policy. That means no rate hikes, barring the ECB repeating the mistakes that were the 2008 and 2011 suicidal hikes. In fact, by tiering the deposit rate the ECB is actually allowing for even deeper cuts into negative territory, even though the objective right now is to cushion banks against an even longer period of unchanged negative policy rates.
- **There's no such a thing as a free lunch in economics, and that also applies to a tiered deposit rate.** The ECB tiering the deposit facility will push up broader money market rates. That's because banks will have a whole chunk of excess liquidity that they will no longer be trying to offload in the money market. Instead, they can park a good part of their excess liquidity at a less negative rate at the ECB (or maybe even zero). So, a tiered deposit rate will push up ESTER (the ECB's new benchmark rate), which has been settling at around -45bps, to or even above the deposit rate of -40bps.

Calendar

TIME	REGION	EVENT	PERIOD	ACTUAL	CONSENSUS	REVISED	PRIOR
08:00	Germany	Current Account Balance	Feb	16.3b	--	18.8b	18.3b
08:00	Germany	Exports SA MoM	Feb	-1.30%	-0.10%	0.10%	0.00%
08:00	Germany	Imports SA MoM	Feb	-1.60%	--	1.40%	1.50%

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:30	France	Bank of France Industrial Sentiment	Mar	101	101
10:00		SNB Total Sight Deposits CHF	Apr/05	--	576.1b
10:30	Eurozone	Sentix Investor Confidence	Apr	-1.7	-2.2
11:30	Germany	Sells EUR3 Bln 189-day Bills (DE0001137792)			
13:00	Cyprus	Sells 91-day Bills			
15:00		Israel Central Bank Rate Decision	Apr/08	0.25%	0.25%
15:45		ECB Weekly QE Overview			
16:00	US	Factory Orders	Feb	-0.50%	0.10%
16:00	US	Factory Orders Ex Trans	Feb	--	-0.20%
16:00	US	Durable Goods Orders	Feb F	--	-1.60%
16:00	US	Durables Ex Transportation	Feb F	--	0.10%
16:00	US	Cap Goods Orders Nondef Ex Air	Feb F	--	-0.10%
16:00	US	Cap Goods Ship Nondef Ex Air	Feb F	--	0.00%
16:30		Riksbank's Floden in Panel on Mortgage Market			
17:30	US	Sells USD42 Bln 3-Month; USD36 Bln 6-Month Bills			
17:45		ECB's Villeroy speaks in Paris			
		IMF/World Bank Annual Spring Meetings			

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